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Comptroller of the Currency
Administrator of National Banks

Community Bank Supervision

Comptroller's Handbook

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Bank Supervision and Examination Process

Introduction

Background

This booklet explains the philosophy and methods of the Office of the Comptroller of the Currency (OCC) for supervising community banks. Community banks are generally defined as banks with less than $1 billion in total assets and may include limited-purpose chartered institutions (e.g., trust banks, community development banks). This booklet also guides the supervision of smaller and less complex mid-sized banks. As mid-sized banks grow in size and complexity, the supervisory process transitions to that outlined in the "Large Bank Supervision" booklet of the *Comptroller's Handbook*.

The community bank supervision process is designed to give examiners flexibility when developing supervisory strategies and conducting examinations, while providing a consistent supervisory framework to respond to the underlying risks in each community bank.

The OCC's community bank supervision is designed to:

- Determine the condition of the bank, as well as the levels and trends of the risks associated with current and planned activities.

- Evaluate the overall integrity and effectiveness of risk management systems by conducting periodic validation.[1]

- Determine compliance with banking laws and regulations.

- Communicate findings, recommendations, and requirements to bank management and directors in a clear and timely manner, and obtain informal or formal commitments to correct significant deficiencies.

- Verify the effectiveness of corrective actions or, if actions have not been undertaken or accomplished, pursue resolution through appropriate supervisory or enforcement actions.

[1] Validation is accomplished by a combination of observation, inquiry, and testing.

The OCC's supervisory framework for community banks consists of the following three components:

- **Core Knowledge** — the OCC's database that contains core information about the institution, its profile, culture, risk tolerance, operations and environment, and key examination indicators and findings. This database enables examiners to document and communicate critical data to each other with greater consistency and efficiency.

- **Core Assessment** — this booklet contains the standards and objectives that guide examiners in reaching conclusions regarding Regulatory Ratings under the Uniform Financial Institutions Rating System (UFIRS, more commonly referred to as "CAMELS") and the Uniform Rating System for Information Technology (URSIT, more commonly referred to as the "I" rating).[2] The core assessment assists examiners in depicting the bank's overall risk profile using risk assessments made under the OCC-developed community bank risk assessment system (RAS). The core assessment also defines the conclusions examiners must reach when completing a full-scope, on-site examination[3] and ongoing monitoring, tailored to the risk profile of each community bank. For examinations of low-risk banks, examiners generally complete only the first objective under each section of the core assessment. These objectives are collectively referred to as the minimum-scope core assessment. For details on the flexibility of timing and scope of supervisory activities, see the "Examining" section of this booklet.

- **Expanded Procedures** — detailed guidance that explains how to examine specific activities or products that warrant extra attention beyond the core assessment. These procedures are found in the other booklets of the *Comptroller's Handbook*. Examiners determine which expanded procedures to use, if any, during pre-examination planning or after drawing preliminary conclusions during the core assessment.

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[2] For more information on UFIRS, URSIT, and other regulatory ratings systems, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*. The group of regulatory ratings required for banks is sometimes referred to by the OCC by the designation of CAMELS/ITCC or CAMELS/I, with the "I" referring to the information technology rating, and the "TCC" referring to the trust, compliance, and community reinvestment activities ratings.

[3] The frequency (12 or 18 months) of full-scope, on-site safety and soundness examinations is based on the bank's condition and complexity as prescribed by 12 USC 1820(d), Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

While serving as the primary guide to the OCC's overall supervision of community banks, this booklet should be used in conjunction with other booklets of the *Comptroller's Handbook*, including "Bank Supervision Process" and the *FFIEC Information Systems (IS) Examination Handbook*.

The supervision of community banks also includes the review of more specialized areas not fully covered by this booklet. For the fiduciary activities core assessment, see the "Community Bank Fiduciary Activities Supervision" booklet of the *Comptroller's Handbook*.

For examination activities for consumer compliance and community development (compliance with the Community Reinvestment Act) in community banks with total assets of less than $250 million or other low-risk community banks, see the "Community Bank Consumer Compliance" booklet of the *Comptroller's Handbook for Compliance*. For compliance-related examination activities for larger community banks, see other booklets of the *Comptroller's Handbook for Compliance*.

The core assessment is designed to achieve the following operational and administrative objectives:

- Incorporate supervision by risk into the community bank examination process in a consistent fashion. Supervisory strategies will be tailored to the risk profile of each community bank.

- Require examiners to assess risk and validate, when appropriate, a bank's risk management control practices.

- Define minimum examination conclusions that examiners must reach during the supervisory cycle, while providing the flexibility to vary the amount of supporting detail or volume of work.

- Provide direction for less-experienced examiners by providing detailed procedural guidance to be used, as needed, to reach key conclusions and objectives.

- Specify when it is appropriate to broaden or expand supervisory activities, based on the risk profile of the bank.

- Ensure conformance with statutory requirements for full-scope examinations.

- Determine examination conclusions and assign RAS and regulatory ratings. Assessments of risk and risk management controls will be considered when determining the regulatory ratings.

Supervision by Risk

The OCC recognizes that banking is a business of taking risks in order to earn profits. While banking risks historically have been concentrated in traditional banking products and services, community banks today offer a wide array of new and complex products and services. Whatever products and services they offer, community banks must have risk management systems that identify, measure, monitor, and control risks. Therefore, risk management systems in community banks will vary based on the complexity and volume of risks assumed by the bank.

OCC examinations of community banks focus on the bank's ability to properly manage risk.[4] Using the core assessment, OCC examiners draw conclusions about the adequacy of a bank's risk management system. When risks are high; when activities, products, and services are more complex; or when significant issues or problems are identified, examiners will expand the scope of their supervisory activities to ensure that bank management has appropriately identified, measured, monitored, and controlled risk.

The community bank supervision process primarily focuses on the individual national bank. Nevertheless, supervision by risk requires examiners to determine whether the risks at an individual bank are mitigated or increased by the activities and condition of the entire holding company. To perform a consolidated risk analysis, examiners may need to obtain information from banks and affiliates (as prescribed in the Gramm-Leach-Bliley Act of 1999 (GLBA)), review transactions flowing between banks and affiliates, and obtain information from other regulatory agencies, as necessary.

Risk Definition

For purposes of the discussion of risk, the OCC evaluates banking risk relative to its impact on capital and earnings. From a supervisory perspective, risk is the potential that events, expected or unanticipated, may have an adverse impact on the bank's capital or earnings.

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[4] For more information on supervision by risk and risk management, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

The existence of risk is not necessarily a problem. Even the existence of high risk in any area is not necessarily a concern, so long as management effectively manages that level of risk. To put risks in perspective, examiners should decide whether the risks a bank assumes are warranted. Generally, a risk is warranted when it is identified, understood, measured, monitored, and controlled. It should be in the bank's capacity to readily withstand the financial distress that such risk could cause. When risks are unwarranted (e.g., not understood, measured, controlled, or backed by adequate capital to support the activity), examiners must communicate to management and the directorate the need to mitigate or eliminate the excessive risks. Appropriate bank actions may include reducing exposures, increasing capital, and/or strengthening risk management processes.

The OCC has defined nine categories of risk for bank supervision purposes. These risks are *credit, interest rate, liquidity, price, foreign currency translation, transaction, compliance, strategic, and reputation*.[5] These categories are not mutually exclusive; any product or service may expose the bank to multiple risks. In addition, risks can be interdependent, with increased risk in one category increasing the risk in other categories. Examiners should be aware of this interaction and assess the impact in a consistent and inclusive manner.

Risk Management

Because of the vast diversity in the risks community banks take, there is no single prescribed risk management system that works for all. Each bank should tailor its risk management program to its needs and circumstances.

Sound risk management systems, however, have several things in common. Regardless of the risk management program's design, each program should:

- *Identify risk*: To properly identify risks, a bank must recognize and understand existing risks or risks that may arise from new business initiatives. Risk identification should be a continuing process, and risks should be understood at both the transaction and portfolio levels.

- *Measure risk*: Accurate and timely measurement of risk is essential to effective risk management systems. A bank that does not have a risk

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[5] The risk definitions are found in the "Risk Assessment System" beginning on page 106.

measurement system has limited ability to control or monitor risk levels. Measurement systems in community banks will vary greatly depending on the type and complexity of their products and services. For more complex products, risk measurement systems should be more sophisticated. All banks should periodically test to make sure that their measurement tools are accurate. Sound risk measurement systems assess the risks individually (transaction level) and in aggregate (portfolio level).

- *Monitor risk*: Banks should monitor risk levels to ensure timely review of risk positions and exceptions. Monitoring reports should be timely, accurate, and informative and should be distributed to appropriate individuals to ensure action, when needed.

- *Control risk*: Banks should establish and communicate risk limits through policies, standards, and procedures that define responsibility and authority. These limits should serve as a means to control exposures to the various risks associated with the bank's activities. The limits should be tools that management can adjust when conditions or risk tolerances change. Banks should also have a process to authorize and document exceptions or changes to risk limits when warranted.

Capable management and appropriate staffing are essential to effective risk management. Bank management is responsible for the implementation, integrity, and maintenance of risk management systems. Management also must keep the board of directors adequately informed about risk-taking activities. Management must:

- Implement the institution's strategy.

- Develop policies that define the institution's risk tolerance and ensure that they are compatible with strategic goals.

- Ensure that strategic direction and risk tolerances are effectively communicated and adhered to throughout the organization.

- Oversee the development and maintenance of management information systems (MIS) to ensure that information is timely, accurate, and pertinent.

When examiners assess risk management systems, they consider the bank's policies, processes, personnel, and control systems. For small community banks engaged in limited or traditional activities, risk management systems may be less formal in scope and structure. Examiners will assess risk control systems consistent with the risk profile of each community bank.

Policies are statements, either written or verbal, of the bank's commitment to pursue certain results. Policies often set standards (on risk tolerances, for example) and may recommend courses of action. Policies should express a bank's underlying mission, values, and principles. A policy review should be triggered when a bank's activities or risk tolerances change.

Processes are the procedures, programs, and practices that impose order on the bank's pursuit of its objectives. Processes define how daily activities are carried out. Effective processes are consistent with the underlying policies and are governed by appropriate checks and balances. In small community banks processes may be effective even when less formal than those in banks that offer more complex products and services.

Personnel are the staff and managers that execute or oversee processes. Bank staff and managers should be qualified and competent; perform as expected; and understand the bank's mission, values, policies, and processes.

Control systems include the tools and information systems (e.g., internal/external audit programs) that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes. Feedback should be timely, accurate, and pertinent — appropriate to the level and complexity of risk taking.

Risk Assessment System

The community bank risk assessment system (RAS) gives examiners a consistent means of measuring the nine risks as defined by the OCC and of determining when the core assessment should be expanded. For seven of the risks — *credit*, *interest rate*, *liquidity*, *price*, *foreign currency translation*, *transaction*, and *compliance* — the examiner assesses **quantity of risk, quality of risk management, aggregate risk,** and **direction of risk.** To make these assessments, examiners use conclusions from the core assessment or expanded procedures and guidance on the risk assessment system.

The risk assessment system was developed to assist in prospectively identifying the risks in the banking system. For effective use of the system, examiners should consider the current condition of the bank as well as factors which may identify risks that are increasing. It is important that examiners are aware of early warning signs that the level of risk may rise.

Under the RAS, an institution's risk profile has four dimensions:

- **Quantity of risk** is the level or volume of risk that the bank faces and is characterized as low, moderate, or high.

- **Quality of risk management** is how well risks are identified, measured, controlled, and monitored and is characterized as strong, satisfactory, or weak.

- **Aggregate risk** is a summary judgment about the level of supervisory concern. It incorporates judgments about the quantity of risk and the quality of risk management (examiners weigh the relative importance of each). Examiners characterize such risk as low, moderate, or high.

- **Direction of risk** is the probable change in the aggregate level of risk over the next 12 months and is characterized as decreasing, stable, or increasing. The direction of risk will influence the supervisory strategy, including the extent that expanded procedures might be used. If the risk is decreasing, the examiner expects aggregate risk to decline over the next 12 months. If the risk is stable, the examiner expects aggregate risk to remain unchanged. If the risk is increasing, the examiner expects aggregate risk to be higher in 12 months.

The quantity of risk and quality of risk management should be assessed independently. Therefore, when assigning the individual RAS ratings, the assessment of the quantity of risk should not be affected by the quality, no matter how strong or weak, of risk management. Also, strong capital support or strong financial performance should not mitigate an inadequate risk management system. The examiner should not conclude that "high" risk levels are bad and "low" risk levels are good. The quantity of risk simply reflects the level of risk the bank accepts in the course of doing business and whether this is good or bad depends on whether its risk management systems are capable of identifying, measuring, monitoring, and controlling that amount of risk.

Because an examiner expects the aggregate risk profile to increase or decrease does not necessarily mean that he or she expects the movement to be sufficient to change the aggregate risk level within 12 months. An examiner can expect movement **within** the risk level. For example, aggregate risk can be high and decreasing even though the decline is not anticipated to change the level of aggregate risk to moderate. In such circumstances, examiners should explain in narrative comments why a change in the risk level is not expected. Aggregate risk assessments of high and increasing or low and decreasing are possible.

Although the two remaining risks, *strategic* and *reputation,* affect the bank's franchise value, they are difficult to measure precisely. Consequently, the OCC modified how the risks are assessed and measured, assessing only **aggregate risk** and **direction of risk**. The characterizations of aggregate and direction of risk are the same as for the other seven risks.

Examiners complete or update the risk assessment system for each community bank at the end of each supervisory activity including quarterly monitoring and record the assessments in Examiner View. Assessments are formally communicated to the bank at the conclusion of the full-scope examination activities by including a page in the report of examination containing a matrix with all of the risk categories and assessments.

The risk assessment system is also updated whenever the examiner becomes aware of changes in the bank's risk profile. For example, examiners could identify changes in the bank's risk profile while performing periodic monitoring activities. Any changes in the aggregate risk assessments during interim supervisory activities are required to be formally communicated to the bank.

Examiners will discuss RAS conclusions with appropriate management and the board. Bank management may provide information that may help the examiner clarify or modify those conclusions. Following the discussions, the OCC and bank management should have a common understanding of the bank's risks, the strengths and weaknesses of risk management systems, management's commitment and action plans to address any weaknesses, and future OCC supervisory plans.

The Supervisory Process

The supervision of community banks is a continual process. Supervisory planning, examining through the use of the core assessment and expanded procedures, and communicating examination findings are integral parts of the supervision process.[6]

Planning

Supervisory strategies are dynamic documents that direct all supervisory activities and help to ensure that sufficient resources are available to address bank risks and fulfill statutory requirements. The strategy focuses examiners' efforts on monitoring the condition of the bank and seeking bank management's commitment to correct previously identified deficiencies.

The portfolio manager assigned by the OCC uses core knowledge — the baseline of information about an individual bank — to develop a specific supervisory strategy tailored to the bank's risk profile. At a minimum, the supervisory strategy for community banks will include completing the core assessment. For areas of higher risk or supervisory concern, the strategy may direct examiners to expand the examination beyond the core assessment. The strategy includes an estimate of resources and the number of days, based on the bank's risk profile, that the OCC will need to effectively supervise the bank. The strategy also includes a narrative supporting the specific strategy that has been developed for the supervisory cycle. The volume of the supporting narrative should vary based on the risk profile and the complexity of the planned supervisory activities.

Each supervisory strategy is based on:

- **Core knowledge** of the bank including, but not limited to, its:
  - Management.
  - Control environment.
  - Market(s).
  - Information technology support and services.
  - Products and activities.
  - Ratings.

[6] Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for more detailed information.

- Risk profile.

- OCC supervisory standards and other factors including:

  - Core assessment.
  - Supervisory history.
  - Applicable economic conditions.
  - Other examination guidelines (e.g., expanded procedures in the *Comptroller's Handbook* and *FFIEC IS Examination Handbook*).
  - Supervisory priorities of the agency that may arise from time to time.

- Statutory examination requirements.

Examining

Examining is a continual process consisting of a series of tailored supervisory activities. Supervisory activities are designed to determine the condition and risk profile of a bank, identify areas in need of corrective action, and monitor ongoing bank activities. Because the risk profiles of community banks are diverse, the OCC recognizes that effective and efficient supervision cannot be accomplished using a rigid set of examination procedures. Today's community banks come in many shapes and sizes, and offer a vast array of products and services to their customers. Examiners use the core assessment and expanded procedures (when necessary) to tailor supervisory activities to ensure that risks within each community bank are appropriately identified and managed.

The OCC's approach to community bank supervision also stresses the importance of determining and validating the bank's condition during the supervisory cycle. However, the process itself is flexible and activities can be completed through different means. While on-site activities are essential to supervision, parts of the core assessment may be effectively performed away from the bank. During the on-site activities, examiners are then free to focus on the remaining items in the core assessment (e.g., discussions with management).

The OCC supervisory approach for community banks also provides flexibility for when on-site activities are completed. Supervisory activities can be completed at one time or at various times throughout the supervisory cycle whatever is appropriate given the bank's risk profile and condition. For example, if an accounting firm or vendor does internal audit work for a number of banks in an area, it may be more efficient to review the firm's work papers as part of a targeted supervisory activity rather than to review each bank's audit work papers during its on-site examination. Examiners may also want to coordinate such reviews with other field offices whose banks employ the same vendor or firm for the same purpose. Target reviews in other examination areas also provide scheduling flexibility when a specific area of examination expertise is needed. Prior to scheduling activities that extend throughout a supervisory cycle, the EIC should discuss the scheduling options with bank management.

Examiners identify supervisory concerns and monitor their correction throughout the supervisory cycle. Generally, during on-site activities, examiners focus on identifying the root cause of deficiencies and ensuring that management is taking appropriate and timely steps to address and correct all deficiencies.

Periodic monitoring, which is a key element of the OCC's supervisory process, is designed to identify changes in the bank's condition and risk profile and to review the bank's corrective action on issues identified during previous supervisory activities. By monitoring community banks, examiners can modify supervisory strategies in response to changes in a bank's risk profile, and respond knowledgeably to bank management's questions. Periodic monitoring makes supervision more effective and on-site activities more focused.

The OCC also conducts specialized examinations of functions and areas not covered by the core assessment section of this handbook. The "Bank Supervision Process" booklet of the *Comptroller's Handbook* has established examination standards for the fiduciary activities of community banks. A community bank's supervisory strategy must include the fiduciary examination activities that will be completed during the bank's normal supervisory cycle, either 12 or 18 months. These activities must be sufficient to update the Uniform Interagency Trust Rating System, and include completing the applicable core assessment conclusions and objectives in the "Community Bank Fiduciary Activities Supervision" booklet of the *Comptroller's Handbook*. A community bank's fiduciary examination strategy should be based on an appropriate assessment of risk from fiduciary activities.

Consumer compliance examinations must commence within 36 months following the completion of the prior compliance examination. The bank's Community Reinvestment Act (CRA) activities are assessed every 36 months to 60 months depending on the bank's asset size, holding company affiliation, and previous composite CRA rating. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for additional information on types of specialized examinations and their cycles.

Examiners must use judgment in deciding how much supporting detail or work is necessary to complete the steps or objectives under the core assessment. The policy for work paper documentation requirements, outlined in PPM 5400-8 (rev), "Supervision Work Papers," states that examiners should retain only those files and documents, preferably in a digital format, necessary to support the scope of the supervisory activity, significant conclusions, ratings changes, or changes in a risk profile. In addition, the work papers should clearly document which procedures were either fully or partially performed.

Completing the Core Assessment

To assist examiners in developing supervisory strategies for each community bank, OCC's Canary[7] early warning process will initially characterize the risk profile of each community bank as either "low-risk," "moderate-risk," or "high-risk."[8] The final risk designation is made by the assistant deputy comptroller (ADC) and approved by district deputy comptrollers, based on their knowledge of the bank and the bank's risk profile. The OCC's portfolio manager will tailor his or her supervisory strategies and core assessment approach using this risk classification, coupled with his or her knowledge of the specific risks in the bank. In general, minimum-scope core assessment objectives are used in low-risk banks, the standard core assessment is used in banks identified as moderate-risk, and a combination of the standard core assessment and expanded procedures (as needed) are used in high-risk banks.

The following chart depicts the relationship between the OCC risk classification and the core assessment:

[7] For additional guidance on reviewing the Canary system information, refer to PPM 5000-34, "Canary Early Warning System."
[8] High-risk banks typically include community banks with composite ratings of 3, 4, or 5, and banks that have been identified as high-risk by the Canary system and confirmed as such by the ADCs.

Core Assessment/Risk
Relationship

Low-Risk	Moderate-Risk to High-Risk		
Minimum-scope Core Assessment	Standard Core Assessment	Plus	Expanded Procedures (when appropriate)

Minimum-scope Core Assessment

The minimum-scope core assessment determines if any significant changes have occurred in business activities, the risk profile, management, or the condition of low-risk community banks since the prior examination. Experienced examiners who are knowledgeable about the bank must complete the minimum-scope core assessment. The OCC has determined that these objectives are sufficient to effectively complete full-scope examinations in low-risk banks. The minimum-scope core assessment establishes the OCC's baseline level of testing and validation that will be performed for each risk area. If no significant changes in the bank's risk profile are identified after completion of the minimum-scope core assessment, no further procedures will need to be done. However, if findings identify supervisory concerns, examiners, with approval from their ADC, have the flexibility to expand the scope of the examination activities by completing selected sections of the standard core assessment and/or expanded procedures. Flexibility in expanding the examination may also be exercised when conducting training assignments or when assignments are being completed by a pre-commissioned examiner. In addition, expanded reviews and procedures may be appropriate in larger community banks, in community banks engaged in more complex operations, and in other situations, as determined by the EIC and ADC, that would benefit from increased testing and validation.

For example, an experienced examiner may decide to complete the minimum-scope core assessment for all areas in a low-risk community bank except asset quality if the bank has been experiencing some limited growth in the credit card portfolio. After completing the standard core assessment for asset quality and finding that supervisory concerns remain, and with approval from the ADC, the examiner may then decide to use selected expanded procedures from the "Credit Card Lending" booklet of the *Comptroller's Handbook*. By selecting all types of procedures available to tailor the scope of the examination, the examiner effectively allocates examination resources to the areas of highest risk.

Standard Core Assessment

For banks not identified as either low-risk or high-risk, examiners will complete the standard core assessment. The standard core assessment contains a detailed list of conclusions examiners must make and objectives they must meet during the course of the examination cycle. Examiners also use the standard core assessment when the minimum-scope objectives do not adequately cover the risk posed by the bank or the area under examination. The standard core assessment will be used in low-risk community banks every 36 months.

While each objective in the standard core assessment must be achieved, examiners typically will not need to carry out every procedure listed under each objective. Instead, experienced examiners can simply summarize their conclusions under each objective, consistent with the bank's condition and risk profile. For less experienced examiners, the standard core assessment provides clarifying steps to help them achieve the objectives.

Expanded Procedures

When specific products or risks are present that warrant a detailed review, examiners should widen the scope of the supervisory activities by completing expanded procedures found in other booklets of the *Comptroller's Handbook* or *FFIEC IS Examination Handbook*. For example, if a bank has a higher-than-normal risk profile, the OCC will expect the bank to have more sophisticated and formalized policies and procedures to identify, measure, monitor, and control risk. In these cases, the EIC, with approval from the ADC, will typically expand the examination activities by using procedures from the appropriate booklet of the *Comptroller's Handbook* to more fully assess risk management processes. If significant issues or areas of increasing risk are identified during the completion of either the minimum-scope or the standard core assessment, the examiner, with approval from the ADC, may also expand the supervisory activities to review areas of concern in more depth. Expanded procedures may include additional transaction testing or a more thorough assessment of the risk management process.

Summary

The core assessment directly links the risk evaluation process to the risk assessment system and the assignment of regulatory ratings.

When using the core assessment, examiners should:

- Use reasoned judgment in determining when to expand the core assessment or to increase the level of detail needed to support the core assessment conclusions.

- Practice good communication skills in investigating and good analytical skills in judging what processes are appropriate, given a bank's size, complexity, and risk profile.

- Consider the results of supervisory activities that took place during the rest of the supervisory cycle.

The community bank core assessment does not address compliance with all applicable laws, rules, regulations, and policies. Nonetheless, examiners must understand the laws, rules, regulations, and policies that relate to the area under examination and must remain alert for any noncompliance.[9] Examiners should note noncompliance and discuss appropriate corrective action with management. Detailed procedures that address compliance with legal and regulatory requirements can be found in the other booklets of the *Comptroller's Handbook* series. In addition, examiners should ensure that supervisory follow-up includes a review of corrective action for any violations noted.

Audit and Internal Control

The standard and minimum-scope core assessments require examiners to evaluate and validate the two fundamental components of any bank's risk management system — audit and internal control. An accurate evaluation of

[9] The "References" section lists some laws, regulations, and other guidance commonly used in community bank examinations. More extensive lists of reference materials are included in the other booklets of the *Comptroller's Handbook* and *FFIEC IS Examination Handbook*.

audit and internal control is crucial to the proper supervision of a bank. The examiner will determine whether the overall audit program and internal control system are strong, satisfactory, or weak. Based on these assessments, the examiner will be able to determine the amount of reliance, if any, that other areas of the examination can place on the audit program and internal control system. Strong audit and internal controls can help to leverage OCC resources by reducing the scope of required supervisory activities needed to assess the quality of risk management.

Internal Control

A system of strong internal control is the backbone of a bank's risk management program. The community bank core assessment includes objectives for assessing a bank's control environment during each examination cycle. The objectives are consistent with industry-accepted criteria[10] for establishing and evaluating the effectiveness of sound internal controls. When examiners use expanded procedures, they should refer to the appropriate booklets of the *Comptroller's Handbook* or to the *FFIEC Information Systems (IS) Examination Handbook* for more information on the types of internal control commonly used in a specific banking function.

Audit

The EIC, with approval from the supervisory office, will tailor the scope of the audit assessment to the bank's size, activities, and risk profile. Examiners assigned to review audit will determine how much reliance can be placed on the audit program by validating the adequacy of the audit's scope and the audit's effectiveness during each examination cycle.

Validation, which encompasses observation, inquiry, and/or testing, generally consists of a combination of examiner discussions with bank/audit management or personnel, audit work paper reviews, and process reviews (e.g., policy adherence, risk assessments, follow-up activities). Examiners will use the following three successive steps, as needed, to validate the audit program:

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[10] The Committee of Sponsoring Organizations of the Treadway Commission (COSO) 1992 report "Internal Control — Integrated Framework" discusses control system structures and components. COSO is a voluntary private-sector organization, formed in 1985, dedicated to improving the quality of financial reporting through business ethics, effective internal control, and corporate governance. COSO was jointly sponsored by the American Accounting Association, the American Institute of Certified Public Accountants, the Financial Executives Institute, the Institute of Internal Auditors, and the National Association of Accountants.

Work Paper Review — During each supervisory cycle, examiners will review samples of work papers from internal audit, including a sample from internal audits outsourced from external parties and a sample from directors' examinations.[11] The sample should represent a cross-section of bank functions, activities, and bank-assigned internal audit ratings, with a bias toward high-risk or rapid growth areas, technology audits, and any products, services, or activities new to the bank. The sample should also be sufficient to provide a basis to validate the scope and quality of the audit program and determine the amount of reliance, if any, that can be placed on the audit program and internal control system. How much reliance can be placed on the audit program and internal control system helps determine the scope of supervisory activities required to assess the quality of risk management in other examination areas. A centralized review of work papers may be performed if a third party performs the internal audit function for two or more national banks.

The review of internal audit work papers, including those from outsourced internal audit and director's examinations, may not be waived during any supervisory cycle. However, the EIC has flexibility in limiting the scope of the work paper reviews (i.e., the number of internal audit programs or work papers to review) based on his or her familiarity with the bank's audit function and findings from the previous review of internal audit. If the EIC plans to perform a limited review of internal audit work papers, discussions should be held with the bank's internal auditor or management, as appropriate, before the examination begins. The purpose of these discussions is to ensure that there have been no significant changes in the audit scope or severity of findings since the prior examination. A more complete review of internal audit work papers should be done every second supervisory cycle.

Examiners typically will not review external audit work papers unless the review of the internal audit function discloses significant issues (e.g., insufficient audit coverage) or unless questions are otherwise raised about matters normally within the scope of an external audit program. Other

[11] If the director's examination consists of traditional internal audit activities (e.g., internal control reviews, transaction testing, etc.), then examiners should review a sample of work papers. When the director's examination provides traditional **external** audit coverage (e.g., financial statement audits, balance-sheet only audit, or attestation of internal controls over financial reporting), review of work papers is not necessary. When the director's examination consists of both internal and external audit work (i.e., serves as a bank's sole audit program with an independent external party using agreed-upon procedures), examiners should review a sample of the work papers dealing with traditional internal audit activities.

situations that might trigger an examiner's review of external audit work papers include:

- Unexpected or sudden changes in the bank's internal or external auditor.
- Significant changes in the bank's external audit program.
- Issues raised that affect the bank's safety and soundness.
- Issues about independence, objectivity, or competence of the external auditor.

In most cases, examiners should meet with bank managers and the external auditor whenever a review of external audit work papers is considered. This discussion may help examiners focus their review on the most relevant work papers or even make the review unnecessary. The EIC should consult with the ADC and notify his or her district accountant before beginning any review of external audit work papers. Requests for access to external audit work papers must be made through bank management and should be specific to the areas of greatest interest. Examiners should also request related planning documents and other information pertinent to the area's audit plan (including the sample selection process). If bank management or the external auditor fails to provide access to the work papers, the EIC should contact his or her district accountant and district counsel and discuss how the situation might be resolved.

Use of Expanded Procedures[12] — If the internal audit work paper review raises questions about audit effectiveness, the examiner should discuss all issues with bank management and the board of directors/audit committee. If questions concerning internal audit effectiveness remain, examiners will consider expanding the scope of the audit review and of any affected functional area of the bank. Issues that would require expanded procedures include:

- Concerns about the competency or independence of internal or external audit.
- Unexplained or unexpected changes in external auditor or significant changes in the audit program.

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[12] For a comprehensive set of audit procedures, refer to the July 2000 "Internal and External Audits" booklet of the *Comptroller's Handbook*. For internal control procedures refer to the "Internal Control" booklet published in January 2001. Additional guidance and procedures are also found in other booklets of the *Comptroller's Handbook* that address specific banking product lines and activities.

- Inadequate scope of the overall audit program, or in key risk areas.
- Audit work papers in key risk areas are deficient or do not support audit conclusions.
- High growth areas without adequate audit or internal control.
- Inappropriate actions by insiders to influence the findings or scope of audits.

The scope of the procedures must be sufficient to determine the extent of problems and their effect on the bank. Examiners should use, when appropriate, internal control questionnaires (ICQs) in conjunction with the expanded procedures.

Verification — After completion of the expanded procedures, if significant concerns remain about the adequacy of audit, internal control, or the integrity of the bank's financial or risk management controls, examiners should consider further expanding the scope of the review to include verification procedures.[13]

Examiners will use verification procedures if any of the following issues are identified:

- Key account records are significantly out of balance.
- Management is uncooperative or poorly manages the bank.
- Management attempts to restrict access to bank records.
- Significant accounting, audit, and internal control deficiencies remain uncorrected from prior examinations or from one audit to the next.
- Bank auditors are unaware of, or are unable to sufficiently explain, significant deficiencies.
- Management engages in activities that raise questions about its integrity.
- Repeated violations of law affect audit, internal control, or regulatory reports.
- Other situations exist that examiners believe warrant further investigation.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district

[13] Verification procedures for all examination areas can be found on the "Examiner's Library" and "e files" CDs.

counsel, and the district accountant should also be notified when direct confirmations are being considered.

As an alternative to having the examiners perform the verifications, the EIC may require the bank to expand its audit program. However, this alternative will be used only if management has demonstrated a capacity and willingness to address regulatory problems, if there are no concerns about management's integrity, and if management has initiated timely corrective action in the past. In other instances, the EIC may consider requiring the bank to contract with a third party to perform the verification procedures. If used, these alternatives must resolve each identified supervisory problem in a timely manner and supervisory follow-up will include a review of audit work papers in the areas where the bank audit was expanded.

At the conclusion of the audit and internal control review, the EIC or designee will discuss findings, any significant weaknesses, and recommendations with audit or risk managers, as appropriate, and with bank management and the board of directors/audit committee. Examiners will summarize these discussions in the examination work papers. Regardless of the assessments assigned to the bank's audit and internal control functions, the report of examination will include comments summarizing the assessments (strong, satisfactory, or weak) and any significant concerns or weaknesses.

If significant audit or internal control weaknesses are identified, the EIC will recommend to the ADC what formal or informal action is needed to ensure timely corrective action. One option that should be considered is requiring bank management to develop a safety and soundness compliance plan consistent with 12 CFR 30, Safety and Soundness Standards. In making this decision, the EIC and the ADC should consider the significance of the weaknesses, management's ability and commitment to effect corrective action, and the risks posed to the bank.

Information Technology

Information technology (IT) is an integral part of modern banking. Without technology, banks would be unable to provide the volume, variety, and complexity of products and services currently offered. Because IT can have a considerable effect on all banking activities, the OCC has integrated the review of technology into the core assessment in two ways. First, examiners consider the effect of technology on each area they review, especially its effect on the accuracy, reliability, and timeliness of automated reports used in the bank's risk management process. Second, examiners assess the potential impact of technology on each of the nine OCC-defined risks.

Technological risk is not defined as a separate category of risk. But because risks are interdependent, a single weakness in technology can increase risk in several risk categories. For example, a weakness in Internet banking controls could lead to increased fraud (i.e., transaction risk). If this fraud becomes public knowledge, reputation risk may also increase. The bank's tarnished reputation can increase the cost of funding or reduce funding's availability (i.e., liquidity and interest rate risks). Examiners should consider this type of domino effect in their assessment of a bank's total risk profile.

Risk-Based IT Examinations

In conducting IT examinations, examiners focus on the major issues and risks that are common to all IT activities. These common issues are:

- **Management of Technology** — the planning and oversight of technological resources and services and ensuring that they support the bank's strategic goals and objectives.

- **Integrity of Data** — the accuracy and reliability of automated information and associated management information systems (MIS).

- **Confidentiality of Information** — the protection of bank and customer information from inadvertent disclosure to outsiders.

- **Availability of Information** — the effectiveness of business resumption and contingency planning.

The community bank core assessment includes minimum standards for IT supervision in the form of examination conclusions and objectives. The core assessment objectives for IT directly correspond to the four common IT issues; examiners are required to reach conclusions on each issue and communicate their conclusions in the report of examination. In situations of greater complexity or increased risk, examiners may expand their review of technology to include procedures from the "Internet Banking" booklet of the *Comptroller's Handbook* or the *FFIEC IS Examination Handbook*.

Examiners review IT on the same examination cycle used for the bank's safety and soundness examination (i.e., 12- or 18-month cycle). Examiners base the scope of the review on the risks identified during previous supervisory activities and on the complexity of a bank's systems.

The OCC has adopted the Uniform Rating System for Information Technology (URSIT) as defined by the FFIEC. Examiners assign an "I" composite rating to all national banks. These ratings are discussed with bank management and are disclosed in the report of examination.

Communicating

The OCC is committed to continual, effective communication with the banks that it supervises. All communications — formal and informal conversations and meetings, examination reports, as well as other written materials — should be professional, objective, clear, informative, and consistent.

Most important, examiners must clearly and concisely communicate significant deficiencies and excessive risks to the bank. When examiners find significant weaknesses or excessive risks, these issues should be thoroughly discussed with bank management and the board of directors. The bank should be given a reasonable opportunity to resolve differences and correct weaknesses.

The OCC must provide the bank's board of directors a report of examination (ROE) once every supervisory cycle (every 12 to 18 months according to statute). The ROE, tailored to the findings of the examination, communicates the overall condition and risk profile of the bank, and it summarizes the examiner's activities and related findings. Significant deficiencies and excessive risks, along with the corrective action to which the board or management has committed, should be detailed in the report of examination's matters requiring attention (MRA) or in other written communications.[14] See appendix D for more detail on the requirements for the ROE.

Appeals Process

The OCC seeks to ensure that its supervision is consistent and equitable, and that it resolves disputes with bankers fairly and expeditiously in an informal, professional manner. When disagreements cannot be resolved in this

[14] For specific guidance on MRAs, refer to the "Bank Supervision Process" booklet of the *Comptrollers Handbook*.

manner, a national bank can ask its OCC supervisory office or the OCC ombudsman to the review the matter.

The OCC ombudsman operates outside the bank supervision area, and reports directly to the Comptroller of the Currency. With the Comptroller's consent, the ombudsman's decision can supercede any appealable agency decision or action (e.g., regulatory ratings). The ombudsman may also report weaknesses in OCC policy to the Comptroller, and may recommend changes in OCC policy.[15]

[15] For additional guidance on the appeals process and the definition of an appealable action, refer to OCC Bulletin 96-18, "National Bank Appeals Process."

Community Bank Core Assessment

Examiners use the core assessment to monitor community banks and to conduct full-scope examinations. The core assessment is risk-based and contains the conclusions and objectives that must be reached during full-scope examinations and when completing monitoring activities within a bank's 12- or 18-month supervisory cycle. Risk considerations and references to the community bank risk assessment system are noted throughout the core assessment. Examiners should be aware of the following:

- Each examination section has ***conclusions*** that examiners must reach and ***objectives*** that they must meet during the course of the examination.
- The procedures listed under each objective are ***optional*** steps to guide the examiner to the objectives.
- Examiners ***do not*** have to answer the optional questions or complete the optional steps.

For banks that have been identified as low-risk by the Canary system and confirmed as such by the ADC based on his or her judgment and knowledge of the bank, only the minimum-scope objectives in the core assessment should be completed. Any expansion beyond these objectives to address particular risk areas should be approved by the supervisory office. The minimum-scope core assessment objectives are located at the beginning of each section. The core assessment is made up of the following sections:

- Examination planning.
- Capital.
- Asset quality.
- Management.
- Earnings.
- Liquidity.
- Sensitivity to market risk.
- Information technology.
- Other areas of examination interest.
- Examination conclusions and closing.

Examination Planning

Planning for the examination is crucial to effective supervision by risk. All of this phase's objectives must be met before the examination begins. The timing of supervisory activities is flexible and during the planning phase the EIC should determine the most appropriate timing configuration based on OCC resources, discussions with bank management, and examination objectives.

Objective 1: Review the bank's characteristics and the examination's preliminary scope and objectives.

1. As appropriate, obtain and review the following:

   - ☐ Prior reports of examination.
   - ☐ Other applicable regulatory agency reports (e.g., holding company reviews, IT servicer examination reports, shared application software reviews (SASRs)).
   - ☐ OCC files:
     - Examination conclusions.
     - Quarterly review comments.
     - Risk assessment system ratings.
     - Canary system.[16]
     - Financial and statistical models and databases (e.g., UBPR).
   - ☐ OCC correspondence file.
   - ☐ Prior examination work papers.
   - ☐ Any other internal or external information deemed pertinent to the bank.

2. As appropriate, discuss the bank and associated risks with the portfolio manager and the ADC.

3. Open the examination in Examiner View.

Objective 2: Develop a plan for and coordinate the full-scope examination.

1. Create a list of examination information for review by assigned examination personnel that may include the following:

[16] For additional guidance in reviewing the Canary system information, refer to PPM 5000-34, "Canary Early Warning System."

- The prior full-scope safety and soundness examination report.
- The most recent reports resulting from other supervisory activities (e.g., specialty area examinations).
- Other regulatory agency reports, as appropriate (e.g., holding company reviews, IT servicer exam reports, SASRs).
- The bank's most recent UBPR and other OCC models.
- The Canary system.
- A report shell that contains all mandatory pages, optional pages, and downloaded financial data, as needed.
- Information from Examiner View.
- Appropriate work papers from the prior examination.

2. Contact bank management and discuss the following, as appropriate:

- Preference for obtaining the request letter information in digital form.
- The examination's timing.
- The examination's general scope and objectives.
- General information about examiners' schedules, staffing levels, and projected time during which examiners will be at the bank.
- The availability of key bank personnel during the examination.
- Significant changes in bank products or services including areas of growth.
- Changes in bank management, key personnel, or operations.
- Results of audit and internal control reviews, any follow-up required by management, and audit staffing.
- Any material changes to internal or external audit's schedule or scope.
- Significant trends or changes in the local economy or business conditions.
- Broad economic and systemic trends affecting the condition of the national banking system as identified by the OCC's National or District Risk Committees, as appropriate.
- Purchase, acquisition, or merger considerations.
- Changes in technology, including operational systems, technology vendors/servicers, critical software, Internet banking, or plans for new products/activities that involve new technology.
- Changes in asset management lines of business.
- Issues regarding consumer compliance or CRA.

- Other issues that may affect the risk profile.
- Management concerns about the bank or OCC's supervision, including any areas the bank would like the OCC to consider in the examination scope.

Note: If the EIC is planning to perform an internal audit work paper review, discussions should be held with the bank's internal auditor or management, as appropriate, before the examination starts. The purpose of these discussions is to ensure that there have been no significant changes in the audit scope or severity of findings since the prior examination.

For examinations using the minimum-scope objectives, a sample of internal and external audit reports and management responses must be reviewed before the examination starts.

Objective 3: Determine the reasonableness of the supervisory strategy for the bank.

1. Determine whether the bank has been identified as low-risk by the Canary system and confirm that the identification is appropriate based on the ADC's judgment and knowledge of the bank.

2. As warranted, review and assess the appropriateness of the current supervisory strategy for the bank. Consider:

   - Information obtained by contacting bank management.
   - Identification as low-risk by the Canary system.
   - Findings from monitoring activities.
   - Discussions with supervisory office personnel.
   - The supervisory cycle for consumer compliance or CRA examinations.

3. If needed, modify the supervisory strategy by either adopting the minimum core assessment based on the bank's identification of low-risk, or identify areas that will require the use of the standard core assessment or expanded procedures. After modifying the strategy, obtain approval from the appropriate supervisory office.

Objective 4: Prepare for full-scope examination activities.

1. As appropriate, draft a scope memorandum if the scope of the examination has been expanded.

2. Coordinate the examination with other regulatory agencies, as necessary.

3. If appropriate, arrange for the installation of a dedicated analog telephone line at the bank through the OCC's Information Technology Services. The request should be made at least 20 days prior to the start date of the examination.

4. For all areas being examined, complete assignments for examining staff.

5. After initial contact with the bank, send a request letter to the bank that provides:

   - The examination start date.
   - The review's scope and objectives.
   - Advance information the bank must provide to the examination team, including due dates for submission of requested items.
   - Information the bank must have available for the examiners upon their arrival at the bank.
   - The name, address, and telephone number of the OCC contact.
   - Information regarding the delivery of digital files.

   Note: Appendix C is a standard request letter for community bank safety and soundness examinations (including IT). The letter should be customized to reflect both the examination's scope and the bank's risk profile. Refer to page 49 of the "Community Bank Fiduciary Activities Supervision" booklet for the fiduciary request letter. For other specialized examinations refer to the appropriate booklets of the *Comptroller's Handbook*.

6. Prepare supplies and work paper files to take to the bank for the examination.

7. After the bank submits the items in the request letter, and generally within one week of the start of the examination, review the items and finalize the scope of the examination.

Objective 5: Conduct on-site planning meetings.

1. Meet with the CEO and appropriate members of senior management, board members, or appropriate board committees at the beginning of the examination to:

   - Explain the scope of the examination, the role of each examiner, and how the team will conduct the examination.
   - Confirm the availability of bank personnel.
   - Identify communication contacts.
   - Answer any questions.

2. Meet with the examination staff at the beginning of the examination to confirm:

   - Scope and objectives.
   - Workdays.
   - Assignments and due dates.
   - Administrative duties.
   - Guidelines for contact and communication between the examining team, bank management, and OCC supervisory offices.

Capital

Conclusion: Capital is rated (1, 2, 3, 4, 5).

Complete this section's objectives to assign the capital component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- The level and quality of capital and the overall financial condition of the institution.
- The ability of management to address emerging needs for additional capital.
- The nature, trend, and volume of problem assets, and the adequacy of the allowance for loan and lease losses and other valuation reserves.
- Balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities.
- Risk exposure represented by off-balance-sheet activities.
- The quality and strength of earnings, and the reasonableness of dividends.
- Prospects and plans for growth, as well as past experience in managing growth.
- Access to the capital markets and other sources of capital, including support provided by a parent holding company.

Note: A financial institution is expected to maintain capital commensurate with the nature and extent of risks to the institution and the ability of management to identify, measure, monitor, and control these risks. When evaluating the adequacy of capital for determining the rating for the capital component, examiners should consider the bank's risk profile.

Minimum-scope Core Assessment Objective: Determine the capital component rating and any potential impact on the bank's risk assessment.

At the beginning of the examination, hold discussions with management covering:

- The bank's present condition and future plans (e.g., dividends, growth, new products, and strategic initiatives)

- Changes in controlling ownership.

Obtain and review the following information and documents, as appropriate:

- Results from OCC monitoring activities and the prior examination.
- Results from other areas of the examination and other examinations that may affect capital adequacy (e.g., earnings, asset quality).
- The Canary system.
- UPBR and other OCC models.

If the bank's activities, risk profile, or risk controls have changed significantly or if they raise substantive issues while the minimum-scope objective is being met, the scope of the examination should be expanded to include appropriate standard core assessment objectives or other appropriate expanded procedures.

Standard Core Assessment Objectives

Objective 1: Determine the scope of the capital review.

1. Review the examination information to identify any previous problems that require follow-up in this area.

2. If not previously provided, obtain and review the following:

   - ☐ The bank's current risk-based capital computation.
   - ☐ Findings from monitoring activities.
   - ☐ A list of shareholders that own 5 percent or more and their percentage of ownership.

3. If necessary, update information about controlling ownership in core knowledge.

4. As appropriate, calculate and distribute capital limits and shareholder information to other examiners.

Objective 2: Determine the adequacy of capital.

1. Review applicable information to identify trends. Consider:

   - Results from monitoring activities.
   - Reports used by bank management to monitor and project capital requirements.
   - The Canary system.
   - UBPR and other OCC model calculations to compare the bank's ratios with those of peer banks.
   - The bank's present condition and future plans.

2. Consider the impact of the following on current or future capital adequacy:

   - Dividends.
   - Earnings.
   - Asset quality and allowance adequacy.
   - Historical and planned growth.
   - On- and off-balance-sheet activities.
   - Strategic initiatives.
   - Financial plans and budgets, including replacement costs for fixed assets and technology.
   - New products, services, or distribution channels.
   - Related organizations.

3. Evaluate the sources of capital. Consider:

   - Earnings retention.
   - Ownership capacity — condition of principal shareholders, parent, or subsidiaries.
   - History of public or private offerings.

Objective 3: Determine the risk to bank capital posed by the aggregate level or direction of any applicable risks.

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk has an adverse impact on current or future capital adequacy. Refer to the section "Risk Assessment System," as needed. Comment as necessary and consider:

	Impact on Capital Aggregate Yes	No	Direction Yes	No	NA
Credit risk	☐	☐	☐	☐	☐
Interest rate risk	☐	☐	☐	☐	☐
Liquidity risk	☐	☐	☐	☐	☐
Price risk	☐	☐	☐	☐	☐
Foreign currency translation risk	☐	☐	☐	☐	☐
Transaction risk	☐	☐	☐	☐	☐
Compliance risk	☐	☐	☐	☐	☐
Reputation risk	☐	☐	☐	☐	☐
Strategic risk	☐	☐	☐	☐	☐

Objective 4: Determine the quality of risk management systems through discussions with key risk managers and analysis of applicable internal or external audit reports.

1. Assess the bank's system of internal control over the capital accounts. Examiners should take into consideration the relevant controls listed in objective 11 of the "Management" section of the core assessment. Examiners should also take into consideration other controls pertinent to capital.

2. Assess the timeliness, completeness, accuracy, and relevance of MIS for capital. Consider the sources of reports, controls over the preparation of reports, and whether the reports' accuracy is independently validated.

Objective 5: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risks.
- Management is able to correct the bank's fundamental problems.
- To propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 6: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 7: Conclude the capital review.

1. Adjust the bank's reported capital ratios to reflect the results of the examination and distribute them to appropriate examining personnel. Consider:

   - Loan charge-offs.
   - Examiner-directed additions to the allowance for loan and lease losses (ALLL).
   - Errors in financial reporting.

2. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., capital adequacy, MRA) for the report of examination.

3. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).

4. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).

Asset Quality

Conclusion: Asset quality is rated (1,2, 3, 4, 5).

Complete this section's objectives to assign the asset quality component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- The quality of risk selection and underwriting standards, soundness of credit administration practices, and effectiveness of risk identification practices.
- The risk rating profile of the loan portfolio, including trend of multiple pass grades (if applicable) and the level, distribution, severity, and trend of problem, classified, nonaccrual, restructured, delinquent, and nonperforming assets for both on- and off-balance-sheet transactions.
- The adequacy of the allowance for loan and lease losses and other asset valuation reserves.
- The credit risk arising from or reduced by off-balance-sheet transactions, such as unfunded commitments, derivatives, commercial and standby letters of credit, and lines of credit.
- The diversification and quality of the loan and investment portfolios.
- The extent of securities underwriting activities and exposure to counterparties in trading activities.
- The existence of asset concentrations.
- The adequacy of loan and investment policies, procedures, and practices.
- The ability of management to properly administer its assets, including the timely identification and collection of problem assets.
- The adequacy of internal control and management information systems.
- The volume and nature of policy exceptions including exceptions to underwriting and risk selection standards.
- The volume and nature of credit documentation and collateral exceptions.

Note: The examiner should consider the ability of management to identify, measure, monitor, and control both the current and planned level of credit risk when assigning the component rating.

Minimum-scope Core Assessment Objective: Determine the adequacy of the ALLL, the asset quality component rating, the quantity of credit risk, and the quality of credit risk management.

At the beginning of the examination, hold discussions with management covering:

- Changes in the administration of the loan portfolio.
- Changes in the lending area's management or staff.
- Changes in loan products, marketing, loan acquisition channels (including third-party relationships), lending policies or practices, or loan growth.
- Changes in the number of loan policy, credit, and collateral exceptions.
- External or internal factors that could affect loan quality.

Obtain and review the following information and documents, as appropriate:

- Results from OCC monitoring activities and the prior examination.
- The Canary system.
- UPBR and other OCC models.
- Past-due and nonaccrual reports.
- Risk-rating distribution reports.
- Problem and "watch" loan lists.
- Insider loan list.
- Concentration of credit reports.
- ALLL analysis.
- List of participations (whole and in-part) purchased and sold since the last examination.
- All loan review reports and any responses since the last examination.
- The detail of any "other asset" accounts that are material to the financial statements.

Review an appropriate sample of loans. The sample should include:

- At least five newly advanced loans.
- Large insider loans.
- Past-due and nonaccrual loans.
- Previously criticized loans and loans from the bank's problem and "watch" loan lists.

The size of the sample should be based on the trends and overall risk posed by those segments of the loan portfolio. The purpose of the review is to determine whether the loans evidence any changes in the bank's risk selection, the bank's underwriting practices, its credit administration, its risk-rating criteria, or any other aspect of its credit risk management. This may be accomplished by reviewing credit files, approval documents, and loan committee minutes. Documentation of credit file reviews can normally be limited to summary comments detailing the loan classification and the facts supporting it. Loan review discussions and meetings to discuss findings are to be held onsite.

If the bank's activities, risk profile, or risk controls have changed significantly or if they raise substantive issues while the minimum-scope objective is being met, the scope of the examination should be expanded to include an expanded loan sample, appropriate standard core assessment objectives, or other appropriate expanded procedures.

Standard Core Assessment Objectives

Objective 1: Determine the scope of the asset quality review.

These procedures apply to both commercial and retail credit portfolios, unless specifically stated otherwise. Refer to the "Loan Portfolio Management" booklet of the *Comptroller's Handbook* for additional guidance on assessing the quality of risk management and when setting the scope of asset quality reviews.

1. Review the examination information to identify any previous problems that require follow-up in this area.

2. If not previously provided, obtain and review reports management uses to supervise the loan portfolio, including but not limited to:

   - ☐ Loan trial balances.
   - ☐ Risk rating reports.
   - ☐ Past-due and nonaccrual reports.
   - ☐ Problem and "watch" loan lists, including retail workout programs.
   - ☐ Concentration of credit reports.
   - ☐ Insider loan lists.
   - ☐ List of participations (in-whole or in-part) purchased and sold since the last examination.

- ☐ Overdraft list.
- ☐ Most recent ALLL analysis.
- ☐ Loan policy, loan underwriting, credit, and collateral exception reports.
- ☐ Findings from monitoring activities.
- ☐ Latest loan review report, including any responses from bank officers.

3. Review the UBPR, Canary system, and other OCC models, and request information to assess the size, composition, and trends in the loan portfolio and any off-balance-sheet exposures. Consider:

    - Current and planned loan growth in relation to bank capital and risk limits.
    - Pockets of high growth.
    - Internal portfolio management reports (loan policy exceptions, credit exceptions, collateral exceptions, concentrations of credit, etc.).
    - Unfunded loan commitments.
    - Deteriorating trends in asset quality indicators.
    - Any other information related to the risk characteristics of the loan portfolio, including:

        – Local/national economic indicators.
        – Trends at other local financial institutions.
        – New products planned or already initiated.

4. Determine, during early discussions with management:

    - How the bank administers the loan portfolio and monitors loan quality.
    - Whether loan products, lending practices (underwriting and risk selection standards, out-of-area lending, etc.), or service distribution channels have changed significantly.
    - Whether any external or internal factors could affect loan quality (e.g., local industry reduction or expansion, management and lending staff changes, changes in credit concentrations, changes in product lines).

5. Read and brief, as appropriate, minutes of the loan committee meetings to review the bank's lending practices.

6. As appropriate, obtain the bank's current loan policies and review any changes made since the last examination. **Note**: The policies should be used mainly as reference tools when completing the loan sample and determining exception levels.

7. Use bank reports to select an appropriate sample of loans from the bank's loan portfolio (commercial, retail, etc.) Consult with the EIC when selecting the sample. Consider:

   - Large-dollar commercial loans.
   - Loan participations (in whole or part) purchased and sold.
   - Significant loan concentrations.
   - New loans in new loan products and in seasoned products or portfolios experiencing rapid growth.
   - Loans securitized and sold which the bank services for investors.
   - Insider loans and loans to affiliates.
   - Lower rated "pass" and "watch" loans.
   - Loans previously identified as structurally weak, loans that are exceptions to lending policies, risk selection, and underwriting standards.
   - Higher risk lending products, such as leveraged finance, high loan-to-value real estate loans, and subprime loans.
   - Loans or lending concentrations to businesses or industries exhibiting signs of weakness or higher risk.
   - Loans on the problem loan list and loans previously classified, significant past-dues, nonaccruals, troubled debt, and restructured loans. (**Note**: Loans that are not reviewed in detail should be discussed without preparing linesheets.)

The size and composition of the loan sample should be commensurate with the quantity of credit risk (including the amount of risk, its quality, and its direction), the adequacy of risk management, the bank's condition, and the objectives of the asset quality review. Examiners should use judgment when determining the focus and extent of testing.

Since credit risk typically poses the largest single risk to a bank's earnings and capital, and loans are the largest asset concentration in most banks, the OCC usually samples a significant percentage of loan portfolios. Examiners use a statistically valid sampling technique or take a judgmental sample. When taking judgmental samples, the OCC has found that 30 percent coverage is usually sufficient to review the portfolios at most banks.

In a stable, well-managed bank that has exhibited few signs of change, examiners should sample a smaller number of new and pass-rated credits for the purpose of determining the continuing adequacy of loan quality and credit risk management.

If the number of exceptions to sound underwriting practices or risk selection practices is significant, or if the bank's risk identification or credit administration is suspect or deficient, the examiner should expand the sample to determine the problems' cause, their seriousness, and their effect on credit quality. Additional samples may also be required, for example, when banks have significant growth, the loan or product mix changes, credit or economic conditions deteriorate, strategic direction or key personnel change, or loan portfolio management is suspect or deficient. The additional sample should target lending areas that prompted the expanded loan coverage.

The types of loans in the sample are as important as how much of the portfolio is being reviewed. The sample should be skewed toward the predominate risks in the portfolio. The higher the risk posed to the bank, the more comprehensive the coverage and testing.

8. Use reports and/or information obtained directly from external sources to verify the balances of any assets serviced by third parties. Examiners should reconcile the balances indicated on the bank's financial records to the information provided by the third party. Any material differences should be investigated thoroughly.

Objective 2: Determine, by testing loans independently, the quantity of credit risk inherent in the loan portfolio.

1. Analyze credits and discuss loans sufficiently to determine a risk rating for each loan reviewed. The analysis should include a review of related debt.

2. Document and support the reasons for each loan rating. Refer to PPM 5400-8 (rev), "Supervision Work Papers," for documentation and work paper requirements.

3. Maintain a list of commercial loans identified as having structural weaknesses during the examiner's analysis of the individual credits.

While the review for structurally weak loans normally requires a minimum sample size of 10 new commercial loans, examiners should use judgment to vary the number of loans based on the significance of the bank's commercial loan portfolio and volume of new commercial loan activity.

4. Maintain a list of loans for which the examiner's or management's ability to rate the loan was impaired because of a lack of sufficient information on credit or collateral. Consider:

   - Patterns or root causes of exceptions.
   - Relation of exceptions to credit processes.
   - The impact on credit risk.

5. For retail loans, perform a portfolio analysis. Consider:

   - Size of the portfolio and rate of growth.
   - Changes in products, marketing channels, underwriting standards, operations, and technology.
   - Level and trends in delinquencies and losses by product.
   - The impact on credit risk.
   - Levels and trends in re-agings, extensions, deferrals, renewals, and rewrites.
   - Dependence on third-party vendors and the adequacy of controls regarding the relationship.

6. Determine conformity with OCC 2000-20, "Uniform Retail Credit Classification and Account Management Policy."

   - Review past-due retail loans (residential real estate, consumer loans, check credit, etc.) and discuss with management. (Unless warranted, detailed line sheets **should not** be prepared.)
   - As appropriate, review the policies and controls and determine the practices for re-aging open-end accounts and extensions, deferrals, renewals, and rewrites of closed-end loans.

7. Determine the credit risk inherent in the loan portfolio as a whole, considering the risk-rating profile, underwriting and risk selection practices, concentrations, loan policy exceptions, credit and collateral exceptions, pricing, collateral coverage, adequacy of analysis and credit administration practices, economic indicators, etc.

Objective 3: Determine the quantity of credit risk associated with other assets.

1. As appropriate, obtain and review a list of the following items:

   - Other real estate (ORE).
   - Repossessed assets.
   - Cash items.
   - Other asset accounts with material balances.

2. If the level of credit risk associated with ORE appears significant, review a sample of ORE to determine whether management applies proper accounting treatment. Consider:

   - Timing and recognition of losses.
   - Accounting for expenses.
   - Risk to capital or adequacy of ORE reserves.

3. Obtain a list of classified investments and other appropriate findings regarding the quality and composition of investments from the examiner evaluating the investment portfolio.

4. In discussion with bank management and based on the review of other assets listed above, determine which items should be classified or charged off.

Objective 4: Determine the adequacy of the ALLL.

1. Evaluate the method used to determine the ALLL balance. Consider:

   - The reasonableness of management's process.
   - The quality and adequacy of the supporting documentation.
   - Findings from the asset quality review.
   - Applicable OCC and interagency guidance.

2. If the ALLL methodology is considered flawed, consult with the EIC to independently determine the adequacy of the ALLL balance. If the ALLL is determined to be inadequate:

   - Calculate the necessary provision to restore the ALLL to an acceptable level.

- Direct bank management to make any necessary adjustments to the call report.
- As appropriate, share these findings with other examining personnel.

Objective 5: Determine the quality of credit risk management systems through discussions with key risk managers, analyses of applicable internal or external audit reports, and loan review reports.

1. Determine whether the number and nature of credit and collateral exceptions, policy exceptions, risk rating changes, or other loan review findings raise concerns about the quality of the credit administration function.

2. Determine whether loan management and personnel are adequate to effectively oversee the quantity of credit risk inherent in the loan portfolio. Consider:

    - Staffing size.
    - Staffing expertise.
    - Compensation systems.

3. Assess the timeliness, completeness, accuracy, and relevance of MIS for credit risk. Consider the sources of reports, controls over the preparation of reports, and whether the reports' accuracy is independently validated. Risk management reports should cover major sources of credit risk identified in objectives 2 and 3 above.

4. Using the findings from achieving the previous objectives, consult with the EIC and other appropriate examining personnel to make preliminary judgments on the adequacy of portfolio risk management systems. Consider:

    - Weaknesses in recognizing and understanding existing risk.
    - Evidence that risk is not measured in an accurate or timely manner.
    - Whether management accurately and appropriately monitors established risk levels.
    - Failure to establish, communicate, and control risk limits.

5. Assess the bank's system of internal control over the credit function. Examiners should take into consideration the relevant controls listed in

objective 11 of the “Management” section of the core assessment. Examiners should also take into consideration other controls pertinent to the credit function.

Objective 6: Using the findings from meeting the previous objectives, determine whether the bank’s risk exposure from asset quality is significant.

Develop preliminary assessments of quantity of credit risk, quality of credit risk management, aggregate credit risk, and direction of credit risk. Refer to the section “Risk Assessment System,” as needed. Comment as necessary.

In consultation with the EIC and other examining personnel, identify any significant risks that should be considered in the risk assessment conclusions.

Objective 7: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank’s risks.
- Management is able to correct the bank’s fundamental problems.
- To propose a strategy to address the bank’s weaknesses and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller’s Handbook* for expanded procedures.

Objective 8: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank’s customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 9: Conclude the asset quality review.

1. Provide and discuss with management a list of credit and collateral exceptions, policy exceptions, loans with structural weaknesses, classified assets, assets listed as special mention, and loan write-ups, as appropriate.

2. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., asset quality, concentrations, MRA) for the report of examination.

3. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).

4. Update Examiner View (e.g., ratings, core knowledge, MRA, violations, concentrations).

5. In discussion with the EIC, provide preliminary conclusions about:

   - The quantity of credit risk.
   - The quality of credit risk management.
   - The aggregate level and direction of credit risk or any other applicable risk. As appropriate, complete the summary conclusions in the section "Risk Assessment System."

Management

Conclusions: Management is rated (1,2,3,4,5).
The quality of audit functions is (strong, satisfactory, weak).
The system of internal control is (strong, satisfactory, weak).

Complete this section's objectives to assign the management component rating. In assigning the rating the examiner should consult the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- Conclusions from all examination areas.
- The level and quality of the board's and management's oversight and support of all the bank's activities.
- The ability of the board of directors and management, in their respective roles, to plan for and respond to risks that may arise from changing business conditions or new activities or products.
- The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities.
- The accuracy, timeliness, and effectiveness of management information and risk-monitoring systems appropriate to the institution's size, complexity, and risk profile.
- The adequacy of audit functions and internal control systems to promote effective operations and reliable financial and regulatory reporting, to safeguard assets, and to ensure compliance with laws, regulations, and internal policies.
- Compliance with laws and regulations.
- Responsiveness to recommendations from auditors and supervisory authorities.
- Management depth and succession.
- The extent to which the board of directors and management is affected by, or susceptible to, a dominant influence or concentration of authority.
- Reasonableness of compensation policies and avoidance of self-dealing.
- Demonstrated willingness to serve the legitimate banking needs of the community.
- The overall performance of the institution and its risk profile.

Note: In determining the component rating for management, examiners assess the capability of the board of directors and management to identify, measure, monitor, and control the risks of an institution's existing and planned activities.

Minimum-scope Core Assessment Objective: Determine the management component rating, the quality of audit functions and internal control systems, the aggregate level of reputation and strategic risk, and consider the potential impact of these findings on the bank's risk assessment.

At the beginning of the examination, hold discussions with management covering changes in:

- Senior management or the board.
- The strategic plan or planning function.
- The audit functions or control systems.

Obtain and review the following information and documents, as appropriate:

- Results from OCC monitoring activities and the prior examination.
- A small sample (not to exceed five programs) of internal audit work papers.
- Board minutes and reports since the last examination.

If the bank's activities, risk profile, or risk controls have changed significantly or if they raise substantive issues while the minimum-scope objective is being met, the scope of the examination should be expanded to include appropriate standard core assessment objectives or other appropriate expanded procedures.

Standard Core Assessment Objectives

Objective 1: Determine the scope of the management review.

1. Review the examination information to identify any previous problems that require follow-up in this area.

2. As appropriate, obtain and review the following:

    - ☐ Board and significant committee minutes since the last examination.

- ☐ Current organizational chart.
- ☐ Findings from OCC monitoring activities.
- ☐ List of directors and their backgrounds.
- ☐ Recent representative packet of board meeting materials.

3. Update the list of directors and executive officers in work papers and Examiner View, as appropriate.

Objective 2: Determine the adequacy of management and board oversight.

1. At the beginning of the examination, discuss with senior management:

   - Major risks (current or planned) and management's strategies to control them.
   - Changes, or planned changes, in senior management or the board since the last examination.
   - The board or board committee structure.
   - Plans for growth or acquisition. Consider:
     - Board-approved strategic plan.
     - Financial and operational plans.
     - Changes in products, services, delivery channels, service providers, etc.
     - Resources and staffing necessary to accomplish strategic goals.
   - The potential impact of management succession plans.

2. Review and brief, as appropriate, the minutes of board and significant committee meetings held since the last examination. Identify any:

   - Potential or actual violations of law. Report any violations of insider laws, regulations, and policies to the EIC.
   - Changes in bank operations or strategy and whether these were approved as part of the bank's strategic planning process.
   - Individuals or factions exercising control over the bank.
   - Directors who are involved in the management of the bank and the degree of their involvement.
   - Changes in the bylaws or articles of association.
   - Directors who do not regularly attend board or committee meetings. Determine:
     - Why they do not attend.

- Whether these individuals are fulfilling their fiduciary responsibilities.

Objective 3: Finalize the scope of the audit review. The examination will include a sample of internal audit work papers, representing a cross-section of the bank's functions, activities, and bank-assigned internal audit ratings. The sample will focus on high-growth or high-risk areas, technology audits, and any products, services, or activities new to the bank.

1. If not previously provided, obtain and review the following, as applicable:

   - ☐ Most recent external audit engagement letter.
   - ☐ Internal and external audit reports issued since the last examination, including management letters, attestation reports, and SAS 70 reports on IT servicers, if any.
   - ☐ Current year audit plan/schedule and status reports.
   - ☐ Management's responses to internal and external audit reports issued since the last examination.
   - ☐ Detailed listing of job duties/responsibilities of internal auditor.
   - ☐ Resumes of audit staff including educational and work background, industry certifications, and recent developmental training.
   - ☐ Audit committee minutes or excerpts of board minutes applicable to audits since the last examination.
   - ☐ Internal audit outsourcing contracts/agreements/reports, etc.

2. In consultation with the EIC and examiners assigned major functional and specialized[17] examination areas, identify and select an appropriate sample of internal audit work papers for validation purposes. Consider having examiners who are responsible for other bank activity and specialized areas review the internal audit work papers associated with those activities.

   Note: In most situations, a **work paper** review of the procedures and testing performed by the internal auditor should be sufficient in scope to substantiate conclusions about the quality and reliability of the auditing work. Audit procedures should not be re-performed.

[17] Refer to the appropriate booklets of the *Comptroller's Handbook*, if needed, for additional guidance when reviewing internal audit work papers of specialized examination areas.

Objective 4: Determine the quality of board oversight of the bank's audit programs.

1. Discuss with management and review board or audit committee minutes or summaries to determine whether:

    - The audit plan, policies, and program, including any changes/updates, are periodically reviewed and approved by the board of directors or its audit committee.
    - The board/audit committee receives sufficient information and reports to monitor the audit function effectively.
    - The board/audit committee ensures that management has properly addressed exceptions noted by internal or external auditors.
    - Audit findings and management's responses have been reported directly to the board or audit committee.
    - The board or audit committee performs due diligence on the competence of external auditors who are not independent public accountants (IPAs).
    - The board or audit committee periodically evaluates the operations of the internal audit function, including any outsourced internal audit activities.
    - At least a majority of the audit committee's members are outside directors when practicable (for banks not subject to 12 CFR 363).

2. If the bank has total assets of $500 million or more, determine compliance with 12 CFR 363, Annual Independent Audits and Reporting Requirements.

Objective 5: Determine the adequacy of audit policies, procedures, and programs. Consider:

- The size, complexity, and risk profile of the bank.
- The quality and effectiveness of the bank's internal control for financial reporting and audit.
- Whether the audit is focused on appropriate areas, given the risk profile of the bank.
- The quality of audit reports and findings.
- The quality and timeliness of management responses to audit findings and whether audit follows up on significant findings in a timely manner to assess the effectiveness of management's responses.

- Reporting lines to the board or audit committee.
- Whether the programs are regularly reviewed to ensure adequate coverage.
- Whether the programs include regular testing of internal control and MIS.
- How much audit participates in the acquisition and implementation of new products, services, and delivery channels, and what its role is in merger, acquisition, and transition activities.
- Whether audit plans address goals, schedules, staffing, and reporting.
- Whether audit scope is adjusted for any significant changes in the bank's environment, structure, activities, risk exposures, systems, or new products or services.
- The use of audit software and other computer-assisted audit techniques.

Objective 6: Determine the competence and independence of the internal audit function. If the bank has no internal audit function, determine management's rationale and any mitigating factors (e.g., strong external audit and internal control systems, limited complexity of operations/low risk). Consider:

- Auditor/staff experience and training.
- Auditor/staff tenure, turnover, and vacancies.
- The quality of audit reports and findings.
- Any incompatible duties performed by the auditor or staff.
- Lines of reporting, i.e., directly to board or audit committee.
- The quality and depth of audit procedures.
- Staff's ability to meet the audit schedule.

Objective 7: Determine the adequacy and effectiveness of outsourced internal audit arrangements, if applicable.

1. Review outsourcing arrangement contracts or engagement letters and determine whether they adequately address the roles/responsibilities of the bank and the internal audit outsourcing vendor (see OCC Bulletin 98-1, "Interagency Policy Statement on Internal Audit and Internal Outsourcing").

2. Determine whether:

   - The arrangement maintains or improves the quality of internal audit and internal control.
   - Key bank employees and the vendor understand lines of communication and how internal control or other problems noted by the vendor are to be addressed.
   - The arrangement compromises the role or independence of a vendor who also performs the external audit of the bank.
   - There are any other relationships between the vendor and management that affect either the vendor's independence or objectivity.
   - Management performs sufficient due diligence to determine the vendor's competence before entering into the arrangement.
   - Procedures exist to ensure that the vendor maintains sufficient expertise throughout the life of the arrangement.

Objective 8: Determine whether the bank has implemented an appropriate external audit function. If the bank has no external audit function, determine management's rationale and any mitigating factors (e.g., strong internal audit and internal control systems, limited complexity of operations/low-risk). Consider:

- The bank's size.
- The nature, scope, and complexity of bank activities.
- The bank's risk profile.
- Actions (taken or planned) to minimize or eliminate identified weaknesses.
- The extent of the bank's internal auditing program.
- Any compensating internal control in place.

1. Contact the external auditor to discuss the external audit scope, results, and ongoing plans and the auditor's communications with the bank's board or audit committee.

2. Determine which of the following types of external audit program the bank has:

   - Financial statement audit.

- Attestation report on management's assertion of financial reporting internal control.
- Balance sheet audit.
- Agreed-upon procedures (e.g., directors' examination, specialized audits such as IT).

3. If a financial statement audit was performed, determine what type of opinion was issued (unqualified, qualified, adverse, or disclaimer).

4. Determine whether the external audit program is performed by an independent public accountant (IPA) or other independent external party and whether the program is appropriate given the bank's size, the nature and extent of its activities/operations, and its risk profile.

5. Review the engagement letter and assess its adequacy. Consider:

   - The purpose and scope of the audit.
   - The period of time to be covered by the audit.
   - The reports expected to be rendered.
   - Any limitations placed on the auditor's scope or work.

5. Determine that the external auditor maintains independence in its relationships with the bank.

6. If the review of internal audit discloses significant issues or if questions are otherwise raised about matters that normally fall within the scope of work performed as part of the external audit program, consider whether external audit work papers for those particular areas where problems or questions exist should be selected for review. Examiners should also consider reviewing appropriate external audit work papers when:

   - An unexpected or sudden change occurs in the bank's internal or external auditor.
   - A significant change occurs in the bank's external audit program.
   - Issues are raised that affect the bank's safety and soundness.
   - Issues are raised about the independence, objectivity, or competence of the external auditor.

   Note: In most cases, examiners should meet with bank managers and the external auditor whenever a review of external audit work papers is being considered. This discussion may help examiners focus their review on the most relevant work papers or even make the review unnecessary. The EIC should consult with the ADC and notify his or her district accountant before beginning any review of external audit work papers. Requests for access to external audit work papers must be made through bank management and should be specific to areas of greatest interest. Examiners should also consider requesting related planning documents and other information pertinent to the area's audit plan (including the sample selection process). Consider having examiners responsible for reviews of other bank activity areas review the external audit work papers associated with those activities. If bank management or the external auditor fails to provide access to the work papers, the EIC should contact his or her district accountant and district counsel and discuss how the situation might be resolved.

Objective 9: Using the findings from all areas under examination, assess the bank's control environment. As appropriate, consider:

- The organizational structure of the bank (e.g., centralized or decentralized, authorities and responsibilities, and reporting relationships).
- Management's philosophy and operating style (e.g., formal or informal, conservative or aggressive, successful risk strategy).
- External influences affecting operations and practices (e.g., independent external audits).
- The goals, objectives, attention, and direction provided by the board of directors and its committees, especially the audit or risk management committees.

Objective 10: Using the findings from all areas under examination, evaluate the bank's internal risk assessment system. As appropriate, consider:

- The effectiveness of the system to identify, measure, monitor, and control the risks.
- The responsiveness of the system to changing risk conditions.
- The competency, knowledge, and skills of personnel.
- Adequacy of blanket bond coverage in relation to bank's risk profile.

Objective 11: Using the findings from all areas under examination, assess the bank's control activities. As appropriate, consider:

- Quality of policies, procedures, and audit functions.
- Timeliness of risk analysis and control processes.
- Approvals and authorization for transactions and activities.
- Supervision and oversight of payments against uncollected funds (potential for kiting).
- Segregation and/or rotation of duties to ensure that the same employee does not originate a transaction, process it, and then reconcile the general ledger account.
- Vacation requirements or periodic unannounced rotation of duties for personnel in sensitive positions.
- Safeguards for access to and use of sensitive assets and records, including wire transfer activities.
- Internal review of employee accounts and expense reports.
- Dual control or joint custody over access to assets (e.g., cash, cash collateral, official checks, and consigned items).
- Independent checks or verifications on function (e.g., lending and wire transfer) performance and reconciliation of balances.
- Timely account reconciliation and resolution/clearing of outstanding items.
- Accountability for the actions taken by bank staff and the responsibilities/authorities given to them.

Objective 12: Using the findings from all areas under examination, assess the bank's accounting, information, and communication systems. As appropriate, determine whether:

- MIS identify and capture relevant internal and external information in a timely manner.
- Systems ensure accountability for assets and liabilities.
- Information systems ensure effective communication of positions and activities.
- Business resumption and contingency planning for information systems are adequate.

Objective 13: Using the findings from all areas under examination, evaluate the bank's self-assessment and monitoring systems. As appropriate, consider:

- Periodic evaluation, self-assessments, or independent audit of internal control.
- Whether the system ensures timely and accurate reporting of deficiencies.
- Processes that ensure timely modification of policies and procedures, as needed.
- Any audit requirements established by the bank's blanket bond company as specified in the insurance application and policy.

Objective 14: Determine whether to expand the scope of the examination or develop a plan for corrective action.

If the review of audit or internal control, including the work paper review, discloses significant control discrepancies or weaknesses that are not mitigated by a satisfactory or strong risk management program, determine which additional examination procedures to perform to identify the extent of problems and determine their effect on bank operations. Expanded procedures will be used if any of the following issues are identified:

- Concerns about the competency or independence of internal or external audit.
- Unexplained or unexpected changes in external auditor or significant changes in the audit program.
- Inadequate scope of the overall audit program, or in key risk areas.
- Audit work papers in key risk areas are deficient or do not support audit conclusions.
- High growth areas without adequate audit or internal control.
- Inappropriate actions by insiders to influence the findings or scope of audits.

Objective 15: If, after completing expanded procedures selected in objective 14, significant concerns remain about the adequacy of audit, the adequacy of internal control, or the integrity of the bank's financial controls, select appropriate verification procedures to determine the root causes of the concerns and the effect on bank operations.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Examiners will use verification procedures if any of the following issues are identified:

- Key account records are significantly out of balance.
- Management is uncooperative or poorly manages the bank.
- Management attempts to restrict access to bank records.
- Significant accounting, audit, and internal control deficiencies remain uncorrected from prior examinations or from one audit to the next.
- Bank auditors are unaware of, or are unable to sufficiently explain, significant deficiencies.
- Management engages in activities that raise questions about its integrity.
- Repeated violations of law affect audit, internal control, or regulatory reports.
- Other situations exist that examiners believe warrant further investigation.

Note: As an alternative to having the examiners perform the verifications, the EIC may require the bank to expand its audit program. However, this alternative will be used only if management has demonstrated a capacity and willingness to address regulatory problems, if there are no concerns about management's integrity, and if management has initiated timely corrective action in the past. In other instances, the EIC may consider requiring the bank to contract with a third party to perform the verification procedures. If used, these alternatives must resolve each identified supervisory problem in a timely manner, and supervisory follow-up will include a review of audit work papers in the areas where the bank audit was expanded.

Objective 16: Using the findings from all areas under examination and from the appropriate objectives above, assess the bank's overall system of internal control (strong, satisfactory, weak) and document conclusions about the bank's internal control system in the report of examination and Examiner View.

1. Incorporate this assessment into assigned CAMELS/I and risk assessment ratings.

2. Prepare MRA comments for any significant control issues and deficiencies.

Objective 17: Assess the adequacy of the bank's overall audit function (strong, satisfactory, weak) and prepare written comments on the bank's audit functions for inclusion in the report of examination and Examiner View. Refer to the "Audit Ratings Matrix" in appendix B for additional guidance.

1. Incorporate this assessment into assigned CAMELS/I and risk assessment ratings.

2. Prepare MRA comments for significant audit issues and deficiencies.

Objective 18: Determine the quality of risk management systems.

Using the findings from meeting the previous objectives, consult with other appropriate examining personnel to make preliminary judgments on the adequacy of risk management systems. Consider:

- Weaknesses in recognizing and understanding existing risk.
- Evidence that risk is not measured in an accurate or timely manner.
- Failure to establish, communicate, and control risk limits.
- Whether management accurately and appropriately monitors established risk levels.

In consultation with other examining personnel, determine whether findings from other areas (e.g., quantity of risk, quality of risk management practices, direction of risk, or aggregate risk) affect the management conclusion. Refer to the section "Risk Assessment System," as needed. Comment as necessary.

Objective 19: Conclude the management review.

1. Develop, in consultation with the supervisory office, action plans to address deficiencies before conducting the exit meeting. Consider management's ability to correct the bank's fundamental problems.

2. Use the results of the foregoing procedures and any other applicable examination findings to compose appropriate comments (e.g., management/administration, MRA) for the report of examination.

3. Communicate findings regarding the adequacy of IT audit coverage and controls to the examiner responsible for consolidating IT conclusions.

4. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).

5. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).

6. In discussion with all examining personnel, draw preliminary conclusions about:

   - The quantity of risk.
   - The quality of risk management.
   - The aggregate level and direction of transaction, reputation, compliance, strategic, or any other applicable risk. As appropriate, complete the summary conclusions in the section "Risk Assessment System."

Earnings

Conclusion: Earnings are rated (1,2,3,4,5).

Complete this section's objectives to assign the earnings component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- The level of earnings, including trends and stability.
- The ability to provide for adequate capital through retained earnings.
- The quality and sources of earnings.
- The level of expenses in relation to operations.
- The adequacy of the budgeting systems, forecasting processes, and management information systems in general.
- The adequacy of provisions to maintain the allowance for loan and lease losses and other valuation allowance accounts.
- The earnings exposure to market risks such as interest rate, foreign currency translation, and price risks.

Note: In rating earnings, the examiner should also assess the sustainability of earnings and any potential impact on earnings of the quantity of risk and the quality of risk management.

Minimum-scope Core Assessment Objective: Determine the earnings component rating and any potential impact on the bank's risk assessment.

At the beginning of the examination, hold discussions with management covering:

- Changes in the bank's budget or budgeting process.
- The bank's present condition and future plans.
- Earnings trends or variances.
- Changes in the bank's call report preparation processes and whether any refilings have occurred.

Obtain and review the following information and documents, as appropriate:

- Results from OCC monitoring activities and the prior examination.
- The Canary system.
- UPBR and other OCC models.
- Budget and variance reports.

If the bank's activities, risk profile, or risk controls have changed significantly or if they raise substantive issues while the minimum-scope objective is being met, the scope of the examination should be expanded to include appropriate standard core assessment objectives or other appropriate expanded procedures.

Standard Core Assessment Objectives

Objective 1: Determine the scope of the earnings review.

1. Review the examination information to identify any previous problems that require follow-up in this area.

2. If not previously provided, obtain and review the following:

   - ☐ Most current balance sheet and income statement.
   - ☐ Most recent budget, variance reports, and related items.
   - ☐ Most recent annual and quarterly reports.
   - ☐ Findings from OCC monitoring activities.

Objective 2: Determine the quality and composition of earnings.

1. Review applicable information to identify trends. Consider:

   - Results from OCC monitoring activities.
   - Management reports used to monitor and project earnings.
   - UBPR and other OCC model calculations to compare the bank's ratios with those of peer banks.
   - The Canary system for potential impact on future earnings.
   - The bank's present condition and future plans.

2. As necessary, discuss earnings trends and variances with management. Coordinate discussions with those examining other functional areas.

3. Analyze earnings composition. Focus on:

   - Core earnings.
   - Net interest margins.
   - Noninterest income and expenses.
   - Loan loss provisions.
   - Off-balance-sheet items.
   - Changes in balance sheet composition.
   - Loan and deposit pricing.
   - Earnings from affiliate transactions

4. Determine the root causes of any significant trends and the impact of nonrecurring items. Consider:

   - Whether earning trends are improving, stable, or declining.
   - Bank earnings compared with:
     - Budget.
     - Peer group.
   - Adequacy of bank earnings in relation to:
     - Debt service requirements of the bank's owner.
     - Dividend-paying capacity. (If appropriate (and in conjunction with the examiner reviewing capital), review and discuss with management the bank's dividend plans.)

5. As appropriate, adjust the bank's reported earnings to reflect the results of the examination and project the current year's net income. Distribute adjustments to appropriate examining personnel.

Objective 3: Determine the adequacy of the bank's budgeting process.

Review and determine the reasonableness of the bank's budget. Consider:

- Economic, market, and other assumptions.
- Historical performance of the budgeting process.
- Examination results.
- Changes in bank management or strategies.
- Variance reports and other supplemental budgeting reports.

Objective 4: Determine the adequacy of management processes to prepare call reports and the validity of call report data.

1. If not previously provided, obtain and review the following:

   - ☐ Most recent call report.
   - ☐ The bank's work papers for that call report.

2. Review and determine the adequacy of the bank's process for preparing call reports. Determine whether the process is periodically and independently verified.

3. As appropriate, verify call report data. Consider:

   - Asking other examiners whether their findings conflict with call report information.
   - Determining whether follow-up is needed.
   - Testing call report accuracy by randomly checking selected call report line items against the bank's work papers and source documents.

Objective 5: Determine the risk to bank earnings posed by the aggregate level or direction of any applicable risks.

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk has an adverse impact on the bank's current or future earnings. Refer to the section "Risk Assessment System," as needed. Comment as necessary and consider:

	Impact on Current or Future Earnings				
	Aggregate		Direction		
	Yes	No	Yes	No	NA
Credit risk	☐	☐	☐	☐	☐
Interest rate risk	☐	☐	☐	☐	☐
Liquidity risk	☐	☐	☐	☐	☐
Price risk	☐	☐	☐	☐	☐
Foreign currency translation risk	☐	☐	☐	☐	☐
Transaction risk	☐	☐	☐	☐	☐
Compliance risk	☐	☐	☐	☐	☐
Reputation risk	☐	☐	☐	☐	☐
Strategic risk	☐	☐	☐	☐	☐

Objective 6: Determine the quality of risk management systems through discussions with key risk managers and analysis of applicable internal or external audit reports.

1. Assess the bank's system of internal control over income and expense accounts. Examiners should take into consideration the relevant controls listed in objective 11 of the "Management" section of the core assessment. Examiners should also take into consideration other controls pertinent to earnings.

2. Assess the timeliness, completeness, accuracy, and relevance of MIS for earnings. Consider the source of reports, controls over the preparation of reports, and whether the reports' accuracy is independently validated.

Objective 7: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risks.
- Management is able to correct the bank's fundamental problems.
- To propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 8: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 9: Conclude the earnings review.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose appropriate comments (e.g., earnings, MRA) for the report of examination.

2. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).

3. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).

Liquidity

Conclusion: Liquidity is rated (1,2,3,4,5).

Complete this section's objectives to assign the liquidity component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- The adequacy of liquidity sources to meet present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition.
- The availability of assets readily convertible to cash without undue loss.
- Access to money markets and other sources of funding.
- The level of diversification of funding sources, both on- and off-balance-sheet.
- How much the bank relies on short-term, volatile sources of funds, including borrowings and brokered deposits, to fund longer term assets.
- The trend and stability of deposits.
- The ability to securitize and sell certain pools of assets.
- The capability of management to properly identify, measure, monitor, and control the institution's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans.

Minimum-scope Core Assessment Objective: Determine the liquidity component rating, the quantity of liquidity risk, and quality of liquidity risk management.

At the beginning of the examination, hold discussions with management covering:

- Changes in liquidity risk management.
- Changes in liquidity planning or funding sources and needs.
- Changes in investment strategy.
- Changes in the liquidity policy or contingency funding plan.

Obtain and review the following information and documents, as appropriate:

- Results from OCC monitoring activities and the prior examination.
- The Canary system.
- UPBR and other OCC models.
- Liquidity reports.
- Investment trial balance.
- ALCO minutes and reports since the last examination.

If the bank's activities, risk profile, or risk controls have changed significantly or if they raise substantive issues while the minimum-scope objective is being met, the scope of the examination should be expanded to include appropriate standard core assessment objectives or other appropriate expanded procedures.

Standard Core Assessment Objectives

Objective 1: Determine the scope of the liquidity review.

1. Review the examination information to identify any previous problems that require follow-up in this area.

2. Obtain and review the following items:

   - ☐ Most recent liquidity reports.
   - ☐ The investment trial balance.
   - ☐ List of investments purchased and sold (within a reasonable time frame).
   - ☐ Findings from monitoring activities.
   - ☐ Any other information or reports management uses (asset/liability committee packages and minutes, etc.).
   - ☐ The Canary system.
   - ☐ Any other OCC-generated filters that pertain to liquidity (e.g., FHLB borrowings).

3. Discuss current investment, liquidity, and funds management strategies with appropriate management.

Objective 2: Determine the adequacy of liquidity and the quantity of liquidity risk.

1. Review the UBPR, Canary system, and the bank's most recent liquidity reports. Identify volume and trends in funding by reviewing:

    - Sources of funding, e.g., retail vs. wholesale.
    - Projected funding needs vs. available sources.
    - Wholesale funding that may be credit sensitive.
    - Funding concentrations.
    - Use and reliance on liabilities with short-term maturities.
    - Asset growth projections.
    - Liquid assets, including:
        - Fed funds sold.
        - Free securities (i.e., unpledged).
        - Saleable loans.
    - Off-balance-sheet commitments.
    - Other liquidity reports used by management to manage liquidity.
    - Contingency funding plan.

2. Evaluate the adequacy of sources of funds to meet anticipated or potential needs. Consider:

    - Money market assets relative to short-term liquidity needs.
    - Other currently available asset liquidity relative to overall liquidity needs, e.g., free (unencumbered) securities.
    - Other potential sources of asset liquidity (securitization, loan sales, cash flow from loans, investments, and off-balance-sheet contracts, etc.).
    - Estimated capacity to borrow under established Fed funds lines relative to short-term liquidity needs.
    - The bank's capacity to increase deposits through pricing and direct-marketing campaigns to meet medium- and long-term liquidity needs.
    - The bank's capacity to borrow under the FHLB collateralized note program or other similar collateralized borrowing facilities.
    - The capacity to issue longer term liabilities and capital instruments to meet medium- and long-term funding liquidity needs. Options may include:
        - Deposit note programs.

    - Medium-term note programs.
    - Subordinated debt.
    - Stock.
  - The capacity to borrow from the discount window.

3. Evaluate the quality of the investment portfolio as a potential source of liquidity. Consider the:

   - Percentage and quality of investment portfolio that is unpledged.
   - Level and impact of portfolio depreciation.
   - Maturity distribution and average life sensitivity of the investment portfolio.
   - Distribution of securities designated held-to-maturity and available-for-sale.
   - Trends in monthly cash flow from the investment portfolio.
   - Potential impact of embedded options on the cash flow patterns.
   - Volume and quality of securities not priced (**Note**: often these securities show a constant price of par).

4. Review the types and levels of funding from wholesale sources. Determine how much the bank relies on wholesale funding sources. Consider:

   - Deposits originating from Internet sources.
   - Fed funds purchased and repurchase agreements.
   - Foreign deposits.
   - Eurodollars.
   - FHLB borrowings.
   - Brokered deposits.

5. Discuss wholesale funding with bank management to determine:

   - How wholesale funding fits in the overall asset/liability strategy.
   - What types of mismatches exist.
   - Whether the wholesale funding strategy is meeting profit expectations.

6. If the bank relies significantly on wholesale funding, including all non-relationship, high-cost funding programs and Internet-based retail

solicitation programs, review factors that influence credit-sensitive funds providers. Consider:

- Current asset quality and potential for deterioration.
- Earnings performance and expectations.
- Changes in senior bank management.
- Negative media attention.
- Rating agency "watch" or downgrade announcements.
- Adverse changes in CAMELS/I.
- Legal restrictions, such as brokered deposits, interbank liabilities, pass-through deposit insurance, Fed discount window borrowing, and prompt corrective action.

7. Considering the foregoing and the relevant risk assessment factors from the "Risk Assessment System," consult with the EIC and other appropriate examining personnel to determine the quantity of liquidity risk.

Objective 3: Determine the quality of liquidity risk management.

1. Determine whether the board has clearly articulated policies and guidelines outlining lines of authority/responsibility for the management of liquidity and its tolerance for liquidity risk. Consider:

   - Has a measurement system that captures and quantifies risk been established?
   - Are limits/guidelines defined and communicated to management?
   - Are the limits/guidelines reasonable?
   - Do the planning, budgeting, and new product areas consider liquidity when making decisions?

2. Determine whether management has planned for adequate sources of liquidity to meet current and potential funding needs.

3. Review the contingency funding plan and determine whether it adequately details management responsibilities, quantifies potential funding needs/sources under multiple scenarios, and prioritizes management action to respond to funding needs. Ensure that the plan is appropriate given the complexity of the bank's circumstances.

4. Determine whether strategies used to achieve the desired mix and maturities of assets and liabilities are adequate. Consider:

   - Discussing with management the bank's liquidity risk strategies.
   - Competitive pressures in the bank's market, considering all funding sources (e.g., branch network, wholesale funding, Internet banking, etc.).
   - Maturity matching through normal runoff and reinvestment.
   - Asset purchases/sales or borrowings and subordinated debentures.
   - Pricing of loans and deposits.
   - Existence of off-balance-sheet items, such as credit lines, derivative contracts, and other commitments.

5. Determine whether MIS is timely, accurate, and complete. Evaluate the effectiveness of MIS including the source of reports, controls over report preparation, and validation of report accuracy by audit. Consider whether MIS monitors:

   - Compliance with risk limits.
   - Sources and uses.
   - Funding concentrations.
   - Funding costs.
   - Availability under wholesale funding lines.
   - Projected funding needs.

6. Determine whether the liquidity management function is audited periodically. Assess whether:

   - The scope and frequency is sufficient.
   - The audit is competent and independent.
   - Internal control and information systems are adequately tested.
   - Weaknesses identified are properly communicated to management and corrective action tracked for follow-up.

7. Assess the system of internal control over liquidity. Examiners should take into consideration the relevant controls listed in objective 11 of the "Management" section of the core assessment. Examiners should also take into consideration other controls pertinent to liquidity.

8. Using the findings from the foregoing, consider the relevant factors from the section "Risk Assessment System"; consult with the EIC and other appropriate examining personnel to determine the quality of liquidity risk management.

Objective 4: Determine the composition and quality of the investment portfolio.

1. Review the UBPR and the bank's MIS to evaluate:

   - Investment yields and market values.
   - Impact of depreciation/amortization on earnings performance or capital adequacy.
   - Significant holdings of nonrated securities, below-investment-grade securities, zero or low coupons, and long maturities.

2. From discussions with management and by reviewing internal reports, assess the trend in credit quality of the investment portfolio between examinations. Determine whether there has been a significant change in the credit risk profile and whether that change has been appropriately managed.

3. From discussions with management and by reviewing internal reports, determine whether there are any issues in the portfolio that are ineligible, in default, or below investment grade. For defaulted or below-investment-grade securities, classify based upon BC 127(rev)[18] and distribute findings, as appropriate, to the examiners reviewing asset quality, earnings, and capital adequacy.

4. Review credit information for securities purchased under the "reliable estimates" authority [12 CFR 1.3(i)], nonrated securities, and below-investment-grade.

5. Review the bank's process for setting and monitoring settlement limits with securities dealers.

Objective 5: Using the findings from meeting the foregoing objectives, determine the significance of liquidity risk.

[18] OCC Banking Circular 127(rev), "Uniform Classification of Assets and Appraisal of Securities."

In consultation with the EIC and other examining personnel, decide whether the aggregate or direction of any risk identified during the liquidity review has had, or is expected to have, an adverse impact on the bank's capital or earnings. Refer to the section "Risk Assessment System," as needed. Comment as necessary.

Objective 6: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risk.
- Management is able to correct the bank's fundamental problems.
- To propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 7: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 8: Conclude the liquidity review.

1. Provide the examiner evaluating asset quality with a list of classified investments, and communicate findings to other examining personnel, as appropriate.

2. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (on, e.g., liquidity adequacy, liquidity management processes, or MRA) for the report of examination.

3. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).

4. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).

5. In discussion with the EIC, provide preliminary conclusions about:

   - The quantity of liquidity risk.
   - The quality of liquidity risk management.
   - The aggregate level and direction of liquidity risk or any other applicable risk. As appropriate, complete the summary conclusions in the section "Risk Assessment System."

Sensitivity to Market Risk

Conclusion: Sensitivity to market risk is rated (1,2,3,4,5).

Complete this section's objectives to assign the sensitivity to market risk component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. (**Note**: Market risk includes interest rate risk, price risk, and foreign currency translation risk.) Consider the following factors from UFIRS:

- The sensitivity of the financial institution's earnings or the economic value of its equity to adverse changes in interest rates, commodity prices, or equity prices.
- The ability of management to identify, measure, monitor, and control exposure to market risk given the institution's size, complexity, and risk profile.
- The nature and complexity of interest rate risk (IRR) exposure arising from nontrading positions.
- The nature and complexity of market risk exposure arising from any trading and foreign operations.

Minimum-scope Core Assessment Objective: Determine the sensitivity to market risk component rating, the quantity of risk and the quality of risk management for interest rate risk, price risk, and foreign currency translation risk.

At the beginning of the examination, hold discussions with management covering:

- Changes to the IRR policy (i.e., limit structures, risk measurement).
- Changes in the IRR management process.
- Material changes in the bank's asset and liability structure.
- Changes in how the investment portfolio impacts IRR.
- Changes in the level of price or foreign currency translation risk.

Obtain and review the following information and documents, as appropriate:

- Results from OCC monitoring activities and the prior examination.

- The Canary system.
- UPBR and other OCC models.
- IRR reports.

If the bank’s activities, risk profile, or risk controls have changed significantly or if they raise substantive issues while the minimum-scope objective is being met, the scope of the examination should be expanded to include appropriate standard core assessment objectives or other appropriate expanded procedures.

Standard Core Assessment Objectives

Objective 1: Determine the scope of the sensitivity to market risk review.

1. Review the examination information to identify any previous problems that require follow-up in this area.

2. Obtain and review the UBPR, Canary system, other appropriate OCC-generated information and the most recent bank-prepared reports used to monitor and manage IRR.

Objective 2: Determine the appropriateness and effectiveness of the risk management practices of the investment portfolio. Follow the guidelines outlined in OCC Bulletin 98-20, “Investment Securities C Policy Statement.”

1. Evaluate board and senior management oversight. Consider:

   - Procedures for approving major policies.
   - Annual review of investment strategies and policies.
   - The establishment of risk limits and procedures to ensure compliance.
   - How well board members and management not involved directly or daily in investment activities understand those activities.

2. Review pre-purchase analyses of recent investments, and determine whether the analyses provide adequate information to understand the price sensitivity of the security.

3. Determine whether the limits (pre-purchase and portfolio sensitivity) established by management are reasonable and serve as an appropriate

subset of bank-wide IRR limits, given the bank's capital, earnings and management's expertise.

4. Determine how well management monitors the investment portfolio. Consider:

   - Whether significant risks in the bank's investment activities are understood and properly reported.
   - The completion and documentation of stress testing on the types of securities as required in the bank's investment policy or procedures.
   - Periodic evaluations of aggregate risk exposure and the overall performance of the investment portfolio.

Objective 3: Determine the quantity of interest rate risk.

Note: The examiner should refer to the "Interest Rate Risk" booklet of the *Comptroller's Handbook* for additional guidance on the considerations listed below.

1. Review exposure to on- and off-balance-sheet positions. Consider:

   - The composition and risk characteristics of asset and liability maturity and cash flow structures.
   - The volatility of the net interest margin over time.
   - The level and impact of basis risk, yield curve risk, options risk, and repricing risk.
   - The support provided by low-cost, stable nonmaturity deposits.

2. Review the level and trend of earnings-at-risk as indicated by the bank's risk measurement system. Risk to earnings should be measured under a minimum change in interest rates of plus or minus 200 basis points within a twelve-month horizon.

3. Review the exposure to the bank's economic value of equity (EVE). If the bank has a significant volume of medium-term to longer term repricing risk and/or options-related positions, review the level and trend of exposure to the economic value of equity. Risk to EVE should be measured under a minimum change in interest rates of plus or minus 200 basis points within a twelve-month horizon.

4. Review the use of derivative products. If the bank's exposure to derivative products is new or is of significant volume, expand the review and refer to the "Risk Management of Financial Derivatives" booklet of the *Comptroller's Handbook*.

5. Evaluate the ongoing performance and effectiveness of any hedging strategies.

6. Using the findings from performing the previous objectives and considering the relevant factors from the section "Risk Assessment System," consult with the EIC and other appropriate examining personnel to determine the quantity of interest rate risk.

Objective 4: Determine the quality of risk management for interest rate risk.

1. Determine whether the board has approved policies establishing responsibility for the management of IRR, communicating risk tolerance, and providing sound guidelines for the management of IRR.

2. Assess the effectiveness of management and the board in overseeing IRR. Consider:

    - The existence and reasonableness of board-approved limits for earnings and/or economic value-at-risk.
    - Compliance with established risk limits.
    - Management's ability, willingness, capacity, and flexibility to adjust the asset/liability mix to reduce IRR.
    - The adequacy of controls over the IRR management process.
    - Management's understanding of IRR and ability to anticipate and respond appropriately to changes in interest rates or economic conditions.

3. Determine whether the risk management system used to measure earnings-at-risk is appropriate for the level and complexity of the bank's exposure. Determine whether the major assumptions used to measure earnings-at-risk are reasonable.

4. Determine whether the risk management system used to measure economic value-at-risk is appropriate for the level and complexity of the bank's exposure. Determine whether the major assumptions used to measure the economic value-at-risk are reasonable.

Note: Calculating the EVE in base-case and rising and falling interest rate environments is the most effective risk measurement method for banks with significant longer term and /or options-related risk positions.

5. Determine whether assumptions used in the risk measurement system are documented with sufficient detail so as to allow verification of their reasonableness and accuracy.

6. Evaluate management's ability and effectiveness in managing IRR. Consider:

   - The level of understanding of the dynamics of IRR.
   - The ability to respond to competitive pressures in financial and local markets.
   - Whether a balanced presentation of risk and return are appropriately considered in asset/liability strategies.
   - The ability to anticipate and respond to adverse or changing economic conditions and interest rates.
   - Whether staff skills are appropriate for the level of complexity and risk.

7. Assess the timeliness, completeness, accuracy, and relevance of MIS. Consider the sources of reports, controls over report preparation, and whether reports' accuracy is independently validated.

8. Determine whether a competent, independent review process periodically evaluates the effectiveness of the IRR management system. In reviewing measurement tools, evaluators should determine whether the assumptions used are reasonable and whether the range of interest rate scenarios considered are appropriate. Refer to the "Interest Rate Risk" booklet of the *Comptrollers Handbook* and OCC Bulletin 2000-16, "Risk Modeling C Model Validation," for more guidance on independent reviews.

9. Assess the adequacy of the system of internal control over IRR. Examiners should take into consideration the relevant controls listed in objective 11 of the "Management" section of the core assessment. Examiners should also take into consideration other controls pertinent to IRR.

10. Using the findings under this objective, determine whether the risk management system to identify, measure, monitor, and control IRR is effective.

11. Using the findings from the foregoing, consider the relevant factors from the section “Risk Assessment System”; consult with the EIC and other appropriate examining personnel to make preliminary judgments on the quality of risk management systems.

Objective 5: Determine the level of price risk or foreign currency translation risk.

1. If the bank engages in trading activities, has investments denominated in foreign currencies, or engages in any other activity that subjects the bank to price risk or foreign currency translation risk, consider:

   - The quantity of risks in relation to bank capital and earnings.
   - The quality of risk management systems including:
     - The ability or expertise of bank management.
     - The adequacy of risk management systems.

2. Determine whether appropriate accounting treatment is used with respect to trading (FAS 115) and foreign currency translation (FAS 52) accounts.

Objective 6: Using the findings from meeting the foregoing objectives, determine the significance of market risk (IRR, price risk, or foreign currency translation risk) to the bank’s capital and earnings.

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk noted during the review of sensitivity to market risk has had, or is expected to have, an adverse impact on the bank’s capital or earnings. Refer to the section “Risk Assessment System,” as needed. Comment as necessary.

Objective 7: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank’s risks.
- Management is able to correct the bank’s fundamental problems.

- To propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 8: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 9: Conclude the review of the bank's sensitivity to market risk.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., sensitivity to market risk, MRA) for the report of examination.

2. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).

3. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).

4. In discussion with the EIC, provide preliminary conclusions about:

   - The quantity of risk.
   - The quality of risk management.
   - The aggregate level and direction of interest rate, price, foreign currency translation, or any other applicable risk. As appropriate, complete the summary conclusions in the section "Risk Assessment System."

Conclusion: **URSIT composite rating is (1,2,3,4,5).**

Complete this section's objectives to assign the information technology (IT) composite rating using as a guide OCC Bulletin 99-3, "Uniform Rating System for Information Technology (URSIT)." The composite URSIT rating should reflect:

- The adequacy of the bank's risk management practices.
- Management of IT resources.
- The integrity, confidentiality, and availability of automated information.
- The degree of supervisory concern posed by the institution.

In assigning the rating the examiner should consult the EIC, the examiners assigned to review management and audit, and other examining personnel, as appropriate. Although the OCC does not assign URSIT component ratings to the financial institutions it supervises, risks arising from the areas covered by the component ratings are considered when assigning the URSIT composite rating.

Minimum-scope Core Assessment Objective: Determine the IT composite rating, the quantity of transaction risk, and the quality of transaction risk management.

At the beginning of the examination, hold discussions with management covering:

- Changes in vendors, systems, applications, distribution channels, or personnel.
- The overall performance of any IT vendors/servicers.
- Changes in the contingency planning process.
- Changes in the processes or reports management uses to monitor IT activity.
- Impact of the changes noted above on the bank's written information security program.

Obtain and review the following information and documents, as appropriate:

- Results from OCC monitoring activities and the prior examination.
- Reports on IT security (including fraud and processing losses) that are provided to management.
- Documentation for major IT initiatives.

If the bank's activities, risk profile, or risk controls have changed significantly or if they raise substantive issues while the minimum-scope objective is being met, the scope of the examination should be expanded to include appropriate standard core assessment objectives or other appropriate expanded procedures.

Standard Core Assessment Objectives

Objective 1: Determine the scope of the information technology review.

Note: Information technology scope decisions should be coordinated with the examiner responsible for completing the audit objectives in the "Management" section of the core assessment.

1. Review the examination information to identify any previous problems that require follow-up in this area.

2. If not previously provided, obtain and review lists describing the complexity of the bank's processing environment and reports management uses to supervise the IT area, including but not limited to:

   - ☐ A list of technology vendors/servicers, description of the products or services provided, and bank's analysis of vendors'/servicers' financial condition.
   - ☐ A list of computer systems and networks.
   - ☐ A list of software and applications that support financial information processing or the risk management process.
   - ☐ Reports used to monitor computer activity, network performance, system capacity, security violations, and network intrusion attempts.

3. Determine during early discussions with management:

   - How management administers and controls IT activities throughout the organization.

- Any significant changes in systems, applications, distribution channels, or personnel since the prior examination or any planned changes.
- How management monitors the quality and reliability of outsourced services and support functions.

Using the information obtained above, decide which systems and applications will be reviewed during this examination. Examples of systems/applications are financial applications, wire transfer, item capture for transmission to a remote processing site, PC- or LAN-based programs or spreadsheets, image processing systems, and Internet banking. Consider:

- The significance of the system or application in supporting bank products and services.
- The volume of transactions processed.
- The average dollar size of the transactions processed.
- How much management relies on the application or its output.
- Recent audit coverage provided internally or externally.
- The most recent OCC examination coverage and changes since that review.

4. If the bank is doing in-house programming or providing automated services to other financial institutions, expand the review as necessary to assess the additional risks inherent in such activities using procedures from the *FFIEC IS Examination Handbook*.

   Procedures should be expanded, as necessary to address complex activities or to provide additional guidance to less experienced examiners.

Objective 2: Assess the adequacy of IT management.

1. Obtain technology-related information from the examiner assigned to review board minutes. Review and brief, as appropriate, minutes of any committees responsible for overseeing and coordinating IT resources and activities to determine user involvement and organizational priorities.

2. Review organizational charts, job descriptions, compensation, turnover, and training programs to ensure that the bank has a sufficient number of technology personnel and that these personnel have the

expertise the bank requires (consider the bank's outsourcing arrangements, as appropriate).

3. Review the effectiveness of the bank's management and monitoring of vendor/servicer activities. Consider the guidance in OCC Advisory Letter 2000 -12, "Risk Management of Outsourcing Technology Services" in evaluating the following:

   - Vender/servicer selection process.
   - Contract guidelines, including customer privacy protections.
   - Monitoring of vendor/servicer performance under the contract, including availability of financial information and access to operations and security audits of the servicer.
   - As applicable, availability of, or access to, application source code and documentation for programs not developed or maintained by the bank. (Generally applies to turnkey software.)

4. Review documentation supporting major projects or initiatives to determine the effectiveness of technology planning, implementation, and follow-up activities. Consider:

   - The decision process, including options considered and the basis for final selection.
   - The reasonableness of implementation plans, including periodic milestones.
   - The effectiveness of monitoring of implementation activities.
   - Whether validation testing of new programs or systems is conducted prior to putting the programs into production.

5. Review the bank's information security program for conformance with 12 CFR 30, appendix B, "Guidelines Establishing Standards for Safeguarding Customer Information."[19] The program must:

   - Be approved and overseen by the board.
   - Be adjusted, as appropriate, for changes in the bank's (or servicer's) processing environment or systems.

[19] The guidelines were mandated by Section 501 of GLBA and are effective on July 1, 2001. Issued jointly by the financial regulatory agencies, they are set forth in OCC Bulletin 2001-8, "Guidelines Establishing Standards for Safeguarding Customer Information."

- Include an annual report to the board (or committee) describing the overall status of the program and the bank's compliance with the guidelines.

6. Review MIS reports for significant IT systems and activities to ensure that risk identification, measurement, control, and monitoring are commensurate with the complexity of the bank's technology and operating environment. MIS should be timely, accurate, complete, and relevant. Consider:

   - Systems capacity including peak processing volumes.
   - Up-time performance and processing interruptions.
   - Network monitoring including penetration attempts and intruder detection.
   - Activity logs and security reports for operations, program and parameter changes, terminals use, etc.
   - Volume and trends of losses from errors, fraud, or unreconciled items.

Objective 3: Assess the adequacy of controls to assure the integrity of data and the resulting MIS.

Note: The review should be coordinated with the examiners responsible for the major CAMELS areas and the internal control portion of the management review to avoid duplication of effort.

1. Evaluate the separation of duties and responsibilities in the operation and data processing areas. Consider:

   - Input preparation and balancing.
   - Data entry.
   - Operation of the computer system.
   - Processing of rejects and unposted transactions.
   - Balancing of final output.
   - Statement and report preparation and distribution.

2. Evaluate the adequacy of input/output controls and reconcilement procedures for batch capture and image capture systems. Consider:

   - Establishment of dollar and item count control totals.

- Review of output and exception reports.
- Reconcilement of application balances to general ledger accounts.
- Balancing and reconcilement of ATM and ACH activity.

3. Review controls and audit trails over master file change requests (such as address changes, due dates, loan payment extension/renewal, loan or deposit interest rates, and service charge indicator). Consider:

   - Individuals authorized to make changes and potential conflicting job responsibilities.
   - Documentation/audit trail of authorized changes.
   - Procedures used to verify the accuracy of master file changes.

4. Assess adequacy of controls over changes to systems, programs, data files, and PC-based applications. Consider:

   - Procedures for implementing program updates, releases, and changes.
   - Controls to restrict and monitor use of data-altering utilities.
   - Process management uses to select system and program security settings (i.e., whether the settings were made based on using sound technical advice or were simply default settings).
   - Controls to prevent unauthorized changes to system and programs security settings.
   - Process and authorizations to change application parameters.

5. Determine whether employees' levels of online access (blocked, read-only, update, override, etc.) match current job responsibilities.

6. Evaluate the effectiveness of password administration for employee and customer passwords considering the complexity of the processing environment and type of information accessed. Consider:

   - Confidentiality of passwords (whether only known to the employee/customer).
   - Procedures to reset passwords to ensure confidentiality is maintained.
   - Frequency of required changes in passwords.
   - Password design (number and type of characters).

- Security of passwords while stored in computer files, during transmission, and on printed activity logs and reports.

7. Determine whether the bank has removed/reset default profiles and passwords from new systems and equipment and determine whether access to system administrator level is adequately controlled.

Objective 4: Evaluate the effectiveness of controls to protect data confidentiality, i.e., to prevent the inadvertent disclosure of confidential information.

1. Evaluate systems used to monitor access and detect unauthorized attempts to access the bank's systems (i.e., intruder detection).

2. Evaluate control and security for data transmitted to or from remote locations. Consider:

   - Type of data transmitted.
   - Use of encryption or other security techniques (e.g., firewalls).
   - Access to network components (servers, routers, phone lines, etc.) that support data transmission.

3. Evaluate controls over remote access (by modem or Internet link) to ensure use/access by authorized users only.

Objective 5: Assess the adequacy of the bank's policies and procedures to ensure the availability of automated information and ongoing support for technology-based products and services.

1. Review the written business resumption contingency plan to ensure that the plan is consistent with the requirements of interagency guidelines. Consider whether:

   - The plan complies with the corporate-wide focus of interagency guidelines.
   - The board of directors or a board committee annually reviews the plan.
   - The plan adequately addresses all mission-critical activities or services.

2. Review the annual validation of the contingency plan, including backup/alternate site test findings. Determine whether the board and senior management were apprised of the scope and results of the backup test.

3. If third-party servicers provide mission-critical activities or systems, ensure that the bank's recovery plan is compatible with the business recovery plans of the servicers.

4. Evaluate planning for event management activities. Consider:

   - Emergency procedures and evacuation plans.
   - Response to network attack or penetration.
   - Reporting to appropriate regulatory or law enforcement agencies.

5. Assess processes and procedures to prevent destruction of electronic files and other storage media. Consider:

   - Frequency of file backup.
   - Access to backup files and storage media (disks, tapes, etc.).
   - Location of off-site file storage.
   - Virus protection for networks and PCs.

6. Determine whether only authorized personnel have access to the computer area, electronic media, supplies of negotiable items, and whether equipment and networks supporting mission-critical services are appropriately secured. Consider physical security as well as environmental controls.

Objective 6: Assess the bank's processes for managing information security risk and transaction risk using the findings from meeting the foregoing objectives, by discussing the processes with key managers, and by analyzing applicable internal or external audit reports.

1. Determine whether the volume and nature of fraud and processing losses, network and processing interruptions, customer-reported processing errors, or audit criticisms lower the quality of automated activities and services.

2. Determine whether the bank's risk assessment process for customer information and its test of key controls, systems and procedures in the

bank's information security program are commensurate with the sensitivity of the information and with the complexity and scope of the bank's activities.

3. Assess the timeliness, completeness, accuracy, and relevance of MIS for transaction risk. Consider the source of reports, controls over report preparation, and independent validation of report accuracy. Risk management reports should cover major sources of transaction risk identified above.

4. Using the findings from meeting the previous objectives, combined with the information from the EIC and other appropriate examining personnel, make preliminary judgments on the quality of transaction risk management systems. Consider:

   - Weaknesses in recognizing and understanding existing risk.
   - Evidence that risk is not measured in an accurate or timely manner.
   - Failure to establish, communicate, and control risk limits.
   - Whether management accurately and appropriately monitors established risk limits.

Objective 7: Using the findings from meeting the foregoing objectives, determine significant risk exposures identified from the review of information technology.

Develop preliminary assessments of quantity of transaction risk, quality of transaction risk management, aggregate transaction risk, and direction of transaction risk. Refer to the section "Risk Assessment System," as needed. Comment as necessary.

In consultation with the EIC and other examining personnel, identify any findings from the information technology review that have significance for other risk rating categories.

Objective 8: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risks.
- Management is able to correct the bank's fundamental problems.

- To propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* or *FFIEC IS Examination Handbook* for expanded procedures.

Objective 9: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 10: Conclude the review of the bank's IT activities.

1. Provide management with a list of deficiencies for consideration.

2. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., IT, MRA) for the report of examination.

3. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).

4. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).

5. In discussion with the EIC, provide preliminary conclusions about:

   - The quantity of risk.
   - The quality of risk management.
   - The aggregate level and direction of transaction risk or any other applicable risk. As appropriate, complete the summary conclusions in the section "Risk Assessment System."

Other Areas of Examination Interest

Standard Core Assessment Objectives

Review the examination information to identify any previous problems that require follow-up in this area.

Consumer Compliance and CRA

Conclusion: Actions taken by management to address significant issues identified during the last consumer compliance or CRA examinations (are, are not) adequate.

Objective 1: Determine whether the latest examinations of consumer compliance or CRA activities raised matters requiring management attention.

Objective 2: Determine whether actions taken by management appropriately address the deficiencies identified.

Fiduciary Activities

Conclusion: Actions taken by management to address significant issues identified during the last fiduciary activities examination (are, are not) adequate.

Objective 1: Determine whether the latest examinations of consumer compliance, CRA activities, or asset management (i.e., fiduciary, retail brokerage, securities custody, and transaction products and services) raised matters requiring management attention.

Objective 2: Determine whether actions taken by management appropriately address the deficiencies identified.

Miscellaneous

Conclusion: Other information reviewed (does, does not) affect the condition of the bank.

Objective1: Review miscellaneous information that may have an adverse impact on the overall condition of the bank or affect the aggregate or direction of any risk.

1. Obtain and review the following items:

   - ☐ List of significant pending litigation, including a description of the circumstances.
   - ☐ Details about the bank's blanket bond insurance.
   - ☐ List of related organizations (e.g., parent holding company, affiliates, operating subsidiaries, chain and parallel-owned banking organizations).
   - ☐ Summary of payments to bank affiliates.

2. Review pending or threatened litigation with management to determine whether litigation has a potentially significant impact on the financial condition of the bank.

3. Review insurance policies (blanket bond, liability, fixed assets and equipment, operating activities, etc.) to determine whether they are current and provide adequate coverage. Consider:

   - Blanket bond coverage in relation to the bank's risk profile and control systems.
   - Compliance with any requirements established by the blanket bond company.
   - Board involvement in the insurance process.

4. Review the relationship C financial or operational C between the bank and the bank's related organizations. Determine whether the transactions between the bank and its related organizations are legal and conform to proper accounting standards and guidance. Consider the impact on:

- Earnings
- Capital
- Funds management practices
- Management

Conclusions — Other Areas of Examination Interest

Using the results of the review of other areas of examination interest, achieve the following objectives:

Objective 1: Determine the quality of risk management systems through discussions with key risk managers and analysis of applicable internal or external audit reports.

1. Assess the bank's system of internal control over the other areas of examination interest. Examiners should take into consideration the relevant controls listed in objective 11 of the "Management" section of the core assessment. Examiners should also take into consideration other controls pertinent to these areas.

2. Assess the timeliness, completeness, accuracy, and relevance of MIS for other areas of examination interest. Consider the source of reports, controls over report preparation, and independent validation of report accuracy.

3. Using the findings from meeting the objectives for other areas of examination interest, consult with the EIC and other appropriate examining personnel to make preliminary judgments on the adequacy of risk management systems.

Objective 2: Using the findings from meeting the foregoing objectives, determine significant risk exposure from the other areas reviewed during the examination.

Discuss with the EIC the findings and any identified risks in these other areas and determine whether the risks are significant enough to adversely affect the bank's condition or risk profile. Refer to the section "Risk Assessment System," as needed. Comment as necessary.

Objective 3: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risks.
- Management is able to correct the bank's fundamental problems.
- To propose a strategy to address the bank's weaknesses and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 4: After completing any expanded procedures, determine whether additional verification procedures should be performed.

Obtain appropriate approvals from the ADC and district deputy comptroller, and contact the Enforcement and Compliance Division, the district counsel, and district accountant prior to performing any direct verification procedures. Verification procedures should be performed only if there is reason to believe that the impact of unresolved safety and soundness issues will be material.

Objective 5: Conclude the examination of other areas.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose comments for appropriate core or optional pages in the report of examination.

2. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).

3. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).

Examination Conclusions and Closing

Conclusion: The bank is rated (1,2,3,4,5).
The bank's overall risk profile is (low, moderate, high).

Minimum-scope Core Assessment Objective: Complete the examination process.

- Determine whether findings from the preceding work, or from other sources, indicate that the scope of the examination should be expanded.
- Determine the composite rating and update other regulatory ratings as appropriate.
- Complete the risk assessment ratings.
- Complete the ROE and discuss findings with the ADC. Refer to appendix D for a detailed summary on requirements for the content of the ROE.
- Prepare the strategy for the next examination cycle.
- Update, as necessary, Examiner View (e.g., core knowledge, surveys).
- Complete and distribute assignment evaluations.
- Conduct a meeting with the board of directors.

An on-site exit meeting should be held with management after they have reviewed the draft ROE.

Standard Core Assessment Objectives

Objective 1: Determine and update the bank's composite rating and other regulatory ratings, as appropriate.

1. Consider findings from the following examination areas:

    - Capital adequacy.
    - Asset quality.
    - Management capability.
    - Earnings quality and quantity.
    - Liquidity adequacy.
    - Sensitivity to market risk.

- Information technology.
- Fiduciary activities.
- Compliance with consumer laws, rules and regulations.
- Performance under the Community Reinvestment Act.
- Other areas of examination interest

2. Ensure that the evaluation of all component ratings has considered the following items as outlined in UFIRS:

   - Institution's size.
   - Institution's sophistication.
   - Nature and complexity of bank activities.
   - Bank's risk profile.

Note: While the regulatory ratings remain point-in-time assessments of a bank's financial, managerial, operational, and compliance performance, the description of each component in the *Comptroller's Handbook* contains explicit language emphasizing management's ability to manage risk. Therefore the conclusions drawn in the risk assessment system should have an appropriate impact on the corresponding component and/or composite rating.

Objective 2: Determine the risk profile using the risk assessment system.

Draw and record conclusions about quantity of risk, quality of risk management, aggregate risk, and the direction of aggregate risk for each of the applicable risk categories. Refer to the matrix in appendix A for additional guidance in assessing aggregate risk.

Note: Using the assessments made of the nine individual risks, the examiner can establish the institution's overall risk profile. The **overall risk profile** is not an average, but a combination of the assessments of the nine individual risks. In establishing the overall risk profile, examiners use judgment to weight the nine risks by the relative importance of each risk.

Objective 3: Finalize the examination. For example, complete the report of examination, and hold meetings with management.

At a minimum, the ROE examination conclusions and comments should include:

- A summary of scope and major examination objectives, including:
  - A recap of significant supervisory activities during the examination cycle and how those activities were used to evaluate the bank's overall condition.
  - Discussions of any significant expansion of the standard core assessment.
- Statements of the bank's overall condition and conclusions on ratings.
- Discussions of any excessive risks or significant deficiencies in risk management and their root causes.
- A summary of actions and commitments to correct any significant deficiencies and planned supervisory follow-up.
- Notice to the board if any civil money penalty referrals are being made.
- A statement about any applicable section 914 requirements.

1. The EIC, or designee, should finalize any required ROE comments. The comments should include significant risk-related concerns. Refer to appendix D for a detailed summary on requirements for the content of the ROE.

2. In consultation with key examining personnel, the EIC should determine whether the bank's condition and risk profile warrant including any of the recommended MRAs in the report of examination. If so, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for specific guidance.

3. Discuss examination conclusions and review any required draft comments with the ADC or the appropriate supervisory office official.

4. Summarize examination conclusions and the bank's condition in the "Examination Conclusions and Comments" page of the report.

5. If any component area is rated 3 or worse, or if the risk profile causes sufficient concern, the EIC should contact the supervisory office before the exit meeting to develop a strategy for addressing the bank's deficiencies.

6. Hold an on-site exit meeting with management to summarize examination findings. Consider:

   - Informing management of areas of success as well as weaknesses.

- Soliciting management's commitment to correct material weaknesses.
- Discussing the bank's risk profile including conclusions from the risk assessment system.
- Offering examples of acceptable solutions, if appropriate.

7. Provide bank management with an approved draft of examination conclusions, MRA comments, and violations of law to allow managers to review the comments for accuracy.

8. Perform a final technical check to make sure that the report is accurate and acceptable. The check should ensure that:

   - The report meets established guidelines.
   - Comments support all regulatory ratings, as applicable.
   - Any numerical totals are accurate.
   - Any numerical data in the report and other supervisory comments are consistent with that in the bank's records.
   - Violations of law are cited accurately.

9. If there are MRA comments in the report, they should also reflect conclusions on management's ability to:

   - Resolve noted problems or issues.
   - Manage the current level of risk (including the likely effects of inaction).

10. Verify that all appropriate information and approvals have been entered in Examiner View and approve the examination.

11. Prepare the supervisory strategy for the next examination cycle. Follow specific guidance in the "Planning" section of this booklet and in the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

12. Complete and distribute assignment evaluations.

13. Schedule the board meeting (if it is not already scheduled).

Objective 4: Prepare for and conduct a meeting with the board of directors.

1. Before completing the examination, prepare for the board meeting by:

   - Drafting a preliminary agenda (formal or informal).
   - Preparing any handouts, graphics, or audiovisual material for the meeting.
   - Reviewing the backgrounds of all board members.
   - Drafting responses to expected questions and comments.

2. Conduct the meeting after the board, or an authorized committee, has had the opportunity to review the draft report or a synopsis of examination findings. At the meeting, graphics and handouts should be used when appropriate so that the examiner can describe:

   - The objectives of OCC's supervision and how the OCC pursues those objectives.
   - Strategic issues including growth, products, and strategies.
   - Major concerns or issues, including significant risks facing the bank.
   - The bank's success or failure in correcting previously identified deficiencies.
   - The potential impact of failing to correct deficiencies.
   - What the OCC expects the bank to do and when (i.e., action plans, supervisory strategies, and commitments).
   - What the bank is doing well.
   - Industry issues affecting the bank.

Note: A supervisory office official, ADC, or their designee must attend the board meeting.

3. Document details of the meeting in Examiner View as a significant event. The following information should be included:

   - The date and location of the meeting and the names of attendees.
   - Major items discussed.
   - A brief summary of the director's reactions to the examiner's briefing. (The entry documenting the meeting can refer the reader to the follow-up analysis comment for further details on any commitments obtained from the board or senior management.)

Community Bank Monitoring

For all community banks, examiners must, at a minimum, determine whether the bank's risk profile has changed and must meet all four related *objectives* each quarter (within 90 days after the end of quarter between full-scope, on-site examinations). When conducting monitoring activities at a newly chartered bank, examiners should supplement their analysis with the guidance in PPM 5400-9, "De Novo and Converted Banks."

Conclusion: The bank's risk profile (has/has not) changed.

Objective 1: Identify, through a review of financial information and discussions with bank management, any significant trends or events that may indicate a change in the risk profile.

1. Review information in the Canary system.

2. For banks identified as low-risk by Canary and confirmed as such by the ADC, **briefly** review[20] quarterly financial information using the UBPR or call report and OCC models.

   For banks not identified as low-risk, conduct a **detailed** financial analysis using the UPBR or call report, and OCC models. **(Sufficient to confirm CAMELS ratings.)**

3. Contact bank management to discuss current information about the bank. Examiners can accomplish this by telephone or an on-site meeting. Particular attention should be paid to areas with significant plans for growth. **Possible** discussion topics include:

   - Financial performance and trends.
   - Significant issues identified by internal and external audit and management's corrective action on those issues.
   - Activities that may affect the bank's risk profile, including changes in:
     - Products, services, distribution channels, or market area.
     - Policies, underwriting standards, or risk tolerances.

[20] The review's purpose is solely to determine any significant financial trends or changes. Such review should take no more than a few minutes if no anomalies are detected.

  - Management, key personnel, organizational structure, or operations.
  - Technology, including operating systems, technology vendors/servicers, critical software, Internet banking, or plans for new products/activities that involve new technology.
  - Control systems (audit, loan review, compliance review, etc.) and their schedule or scope.
  - Legal counsel and pending litigation.
- Purchase, acquisition, or merger considerations.
- Broad economic and systemic trends affecting the condition of the national banking system as identified by the OCC's National or District Risk Committees, as appropriate.
- Trends in the local economy or business conditions.
- Public information disclosed since the last review:
  - Recent media coverage.
  - Market or industry information for publicly traded companies, such as 10Q and securities analyst reports.
- Changes in asset management lines of business.
- Issues regarding consumer compliance or CRA.
- Other issues that may affect the risk profile.
- Management concerns about the bank or OCC's supervision.

4. Perform, as appropriate, any follow-up on previously identified weaknesses.

   Note: Examiners should follow up on previously identified weaknesses throughout the supervisory cycle. Follow-up activities are documented separately from the quarterly review in Examiner View.

Objective 2: Determine any changes in the risk profile.

Using the findings from objective 1, determine whether any changes should be made in the risk assessments. **If no changes are evident, no further review is needed.**

If significant trends or other information evidence a change in the risk profile, including significant growth or changes in activities, perform additional procedures, as necessary, to assess the quantity of risk and determine whether risk management practices are of sufficient quality to mitigate any increased risk. Possible procedures include, but are not limited to:

1. Conducting a **detailed** financial analysis using UBPR/call report information.

2. Requesting information from the bank that may provide insight into any significant changes, new activities, growth, or financial trends. Consider the following:

   - Balance sheet.
   - Income statement.
   - Budget and pro forma financial statements.
   - Management and board reports.
   - Loan review, audit, and compliance management reports.
   - Board and committee minutes.

3. Visiting the bank to assess risk management systems and perform transaction testing on areas with significant changes, new activities, growth, or financial trends. Procedures in the appropriate booklets of the *Comptroller's Handbook* should be used, as necessary.

Objective 3: Update CAMELS/ITC ratings and the supervisory strategy, as appropriate.

1. In consultation with the appropriate supervisory office official, determine whether the results of the quarterly review or other monitoring activities necessitate changes to the CAMELS/ITC component ratings.

2. Determine whether the results of the quarterly review or other monitoring activities affect the supervisory strategy with regard to:

   - Types of supervisory activities planned.
   - Scope of the reviews.
   - Timing or scheduling.
   - Resources (expertise, experience level, or number of examiners).

Objective 4: Communicate and document findings from and any new information obtained during monitoring activities.

1. Update Examiner View including, but not limited to:

- Any changes to:
  - Risk assessment system.
  - CAMELS/ITC ratings.
  - Supervisory strategy.
  - Core knowledge.
- Examination conclusion/analysis comments.

Note: Documentation in Examiner View and work papers should be sufficient to support conclusions based on the extent of findings and work performed.[21] **For example, if the findings are that the risk profile or CAMELS/ITC ratings have not changed, the only required documentation is a statement that the objectives were met and that the bank's risk profile has not significantly changed since the prior review.**

If there are significant changes, the examiner should document any procedures performed under objective 2 and the effect of the changes on the risk assessment system, CAMELS/ITC ratings, and the supervisory strategy.

2. If significant issues are identified, either send written communication or conduct a meeting with the board or management.

   Any change in an aggregate risk assessment or any CAMELS/ITC rating must be communicated in writing to the board of directors.

[21] See guidelines in PPM 5400-8 (rev), "Supervision Work Papers," PPM 5000-34, "Canary Early Warning System," and the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

Credit Risk

Credit risk is the current and prospective risk to earnings or capital arising from an obligor's failure to meet the terms of any contract with the bank or otherwise to perform as agreed. Credit risk is found in all activities in which success depends on counterparty, issuer, or borrower performance. It arises any time bank funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet.

Summary Conclusions:

The quantity of credit risk is:

☐ Low	☐ Moderate	☐ High

The quality of credit risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

Examiners should consider both the quantity of credit risk and the quality of credit risk management to derive the following conclusions:

Aggregate credit risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of credit risk

Quantity of credit risk is derived from the **absolute amount** of credit exposure and the **quality** of that exposure. How much credit exposure a bank has is a function of:

- The level of loans and other credit/credit-equivalent exposures relative to total assets and capital and
- The extent to which earnings are dependent on loan or other credit/credit-equivalent income sources.

All else being equal, banks that have higher loans-to-assets and loans-to-equity ratios and that depend heavily on the revenues from credit activities will have a higher quantity of credit risk. The quality of exposure is a function of the risk of default and risk of loss in assets and exposures comprising the credit exposure. However, the risk of default and loss is not always apparent from currently identified problem assets. It also includes potential default and loss that will be affected by factors such as bank risk selection and underwriting practices, portfolio composition, concentrations, portfolio performance, and global, national, and local economic and business conditions.

To determine the quantity of credit risk, examiners must consider an array of quantitative and qualitative risk indicators. These indicators can be leading (rapid growth), lagging (high past-due levels), static (greater/less X%), relative (exceeds peer/historical norms), or dynamic (trend or change in portfolio mix). Many of these indicators are readily available from call report and UBPR information. Other indicators, such as a bank's risk tolerance or underwriting practices, are more subjective.

It is extremely important to note that banks can exhibit an increasing or high level of credit risk even though many, or all, traditional lagging indicators or asset quality indicators are low. Although a qualitative indicator may have the opposite effect on credit risk that a quantitative indicator has (the one may mitigate the other's effect), the indicators can also work together (the one may add to the other's effect). While each type of measure can provide valuable insights about risk when viewed individually, they become much more powerful for assessing the quantity of risk when viewed together.

Indicators

Examiners should consider the following evaluation factors, as appropriate, when assessing the quantity of credit risk. An assessment of low, moderate, or high should reflect the bank's standing relative to existing financial risk benchmarks and/or peer or historical standards, and should take into consideration relevant trends in risk direction. In considering the effect of trends on the quantity of risk, examiners must consider the rate of change as well as the base level of risk from which the change occurs. (For example, a modest adverse trend in a bank with a moderate quantity of credit risk should weigh more heavily on the examiner's decision to change the quantity of risk rating than a modest adverse trend in a low-risk bank.) These factors represent minimum standards, and examiners should consider additional factors as appropriate.

Low	Moderate	High
The level of loans outstanding is low relative to total assets.	The level of loans outstanding is moderate relative to total assets.	The level of loans outstanding is high relative to total assets.
The ratio of loans, to equity capital is low.	The ratio of loans to equity capital is moderate.	The ratio of loans to equity capital is high.
Growth rates are supported by local, regional and/or national economic and demographic trends, and level of competition. Growth has been planned for, and appears consistent with management and staff expertise and/or operational capabilities.	Growth rates exceed local, regional and/or national economic and demographic trends and level of competition. Some growth has not been planned or exceeds planned levels, and may test management and staff expertise or operational capabilities.	Growth rates significantly exceed local, regional and/or national economic and demographic trends, and level of competition. Growth was not planned or exceeds planned levels, and stretches management and staff expertise and/or operational capabilities. Growth may be in new products or with out-of-area borrowers.
The bank has well diversified income and dependence on interest and fees from loans and leases is low.	The bank is dependent on interest and fees from loans and leases for the majority of its income, but income sources within the loan portfolio are diversified.	The bank is highly dependent on interest and fees from loans and leases. Bank may target higher risk loan products for their earnings potential. Loan income is highly vulnerable to cyclical trends.
The ALLL as a percentage of both problem and total loans is high.	The ALLL as a percentage of both problem loans and total loans is moderate.	The ALLL as a percentage of both problem loans and total loans is low.
Loan yields are low **and** risk and returns are well balanced.	Loan yields are moderate. Imbalances between risk and return may exist, but are not significant.	Loan yields are high **and** reflect a balance between risk and return, and/or risk is disproportionately high relative to returns.

Quantity of credit risk - continued

Low	Moderate	High
Existing and/or new extensions of credit reflect conservative underwriting and risk selection standards. Policies are conservative and exceptions are nominal.	Existing and/or new extensions of credit generally reflect conservative to moderate underwriting and risk selection standards. Policies and exceptions are moderate.	Existing and/or new extensions of credit reflect liberal underwriting and risk selection standards. Policies either allow such practices or practices have resulted in a high amount of exceptions.
The bank has only occasional loans with structural weaknesses and/or underwriting exceptions. Those loans are well mitigated and do not constitute an undue risk.	The bank has an average level of loans with structural weaknesses and/or exceptions to sound underwriting standards consistent with balancing competitive pressures and reasonable growth objectives.	The bank has a high level of loans with structural weaknesses and/or underwriting exceptions that expose the bank to heightened loss in the event of default.
Underwriting policies incorporate conservative collateral requirements. Collateral valuations are timely and well supported.	Underwriting policies incorporate acceptable collateral requirements. Bank practices result in moderate deviations from these policies. A moderate number of collateral valuations are not well supported or reflect inadequate protection. Soft collateral (enterprise value, etc.) is sometimes used in lieu of hard collateral.	Collateral requirements are liberal, or if policies incorporate conservative requirements, there are substantial deviations. Collateral valuations are frequently unsupported or reflect inadequate protection. Soft collateral (enterprise value, etc.) is frequently used rather than hard collateral. Collateral valuations may not be obtained.
Loan documentation and/or collateral exceptions are low and have minimal impact on risk of loss.	The level of loan documentation and/or collateral exceptions is moderate, but exceptions are corrected in a timely manner and generally do not expose the bank to risk of loss.	The level of loan documentation and/or collateral exceptions is high. Exceptions are outstanding for inordinate periods and the bank may be exposed to heightened risk of loss.
The bank's portfolio is well diversified with no single large concentrations, and/or a few moderate concentrations. Concentrated exposures are generally not -correlated. Concentrations are well within internal limits.	The bank has one or two material concentrations, but these and other moderate concentrations are not correlated. Concentrations are in compliance with internal guidelines, but may be approaching the limits.	The bank has one or more large concentrations. These exposures may be correlated to each other or to moderate concentrations exposures in the portfolio. Concentrations may have exceeded internal limits.
Interest earned and not collected relative to total loans is low.	Interest earned and not collected relative to total loans is moderate.	Interest earned and not collected relative to total loans is high.
Change in portfolio mix is low and risk neutral or reducing.	Change in portfolio mix is moderate and may increase overall risk profile.	Change in portfolio mix is moderate to high or significantly increases portfolio risk.
ALLL coverage of problem and noncurrent loans and loan losses is high. Provision expense is stable.	ALLL coverage of problem and noncurrent loans is moderate, but provision expense may need to be increased.	ALLL coverage of problem and noncurrent loans is low. Special provisions may be needed to maintain acceptable coverage

Quantity of credit risk - continued

Low	Moderate	High
Quarterly and annual earnings are well in excess of net loan losses.	Earnings coverage of net loan losses is moderate. Annual earnings provide adequate coverage, but quarterly coverage may display some tightness.	Earnings coverage of net loan losses is low. Annual and quarterly earnings provide minimal or inadequate coverage.
The level of loans past due 30 to 89 days is low and the trend is stable.	The level of loans past due 30 to 89 days is moderate, the trend is stable or rising slowly.	The level of loans past due 30 to 89 days is high or is moderate and the trend is increasing rapidly. Level probably exceeds bank's plan.
The level of noncurrent loans (90 day + past due and nonperforming) is low and the trend is stable.	The level of noncurrent loans (90 day + past due and nonperforming) is moderate, the trend is stable or rising slowly.	The level of noncurrent loans (90 day + past due and nonperforming) is high or is moderate and the trend is increasing.
Classified loans represent a low percentage of loans and capital, and are not skewed to the more severe categories (doubtful or loss).	Classified loans represent a moderate percentage of loans and capital and are not skewed to the more severe categories (doubtful or loss).	Classified loans represent a high percentage of loans and capital or a moderate percentage of loans and capital and are growing or are skewed to the more severe categories (doubtful or loss).
Special mention loans represent a low percentage of loans and capital. Rating changes within criticized/classified are evenly distributed between upgrades and downgrades.	Special mention loans represent a moderate percentage of loans and capital. Downgrades are starting to predominate criticized/classified rating changes.	Special mention loans represent a high percentage of loans and capital. The majority of criticized/classified rating changes are downgrades.
Distribution of pass-rated credits is consistent with a conservative risk appetite. Migration trends within the pass category are balanced or favor higher ratings.	Distribution of pass-rated credits is consistent with a moderate-risk appetite. Migration trends within the pass category are starting to favor the lower or riskier pass ratings.	Distribution of pass-rated credits is heavily skewed toward the lower or riskier pass ratings. Downgrades predominate rating changes within the pass category.
Loan losses to total loans are low.	Loan losses to total loans are moderate.	Loan losses to total loans are high
Bank re-aging, extension, renewal, and refinancing practices raise little or no concern about the accuracy/transparency of reported problem loan, past due, nonperforming and loss numbers.	Bank re-aging, extension, renewal, and refinancing practices raise some concern about the accuracy/transparency of reported problem loan, past due nonperforming and loss numbers.	Bank re-aging, extensions, renewal, and refinancing practices raise substantial concern about the accuracy/transparency of reported problem loan, past due nonperforming and loss numbers.
Relevant economic factors are positive and stable or improving.	Relevant economic factors are positive but deteriorating.	Relevant economic factors are no longer positive and are deteriorating.
Quarterly/annual rate of unfavorable change in any of the above is low.	Quarterly/annual rate of unfavorable change in any of the above is moderate.	Quarterly/annual rate of unfavorable change in any of the above is high.

Quality of credit risk management

Examiners should use the following indicators, as appropriate, when assessing the quality of credit risk management. (For more comprehensive guidelines on portfolio management refer to the "Loan Portfolio Management" booklet of the *Comptroller's Handbook*.)

Strong	Satisfactory	Weak
Lending policies effectively establish and communicate portfolio objectives, risk tolerances, and loan underwriting and risk selection standards.	Policies are fundamentally adequate. Enhancements can be achieved in one or more areas, but are generally not critical. Specificity of risk tolerance, or underwriting and risk selection standards may need improvement to fully communicate policy requirements.	Policies are deficient in one or more ways and require significant improvement in one or more areas. They may not be sufficiently clear or are too general to adequately communicate portfolio objectives, risk tolerances, and loan underwriting and risk selection standards.
Bank effectively identifies, approves, tracks, and reports significant policy, underwriting, and risk selection exceptions individually and in aggregate.	Bank identifies, approves, and reports significant policy, underwriting, and risk selection exceptions on a loan-by-loan basis. However, little aggregation or trend analysis is conducted to determine the affect on portfolio quality.	Bank approves significant policy exceptions, but does not report them individually or in aggregate, and/or does not analyze their affect on portfolio quality. Policy exceptions may not receive appropriate approval.
Credit analysis is thorough and timely both at underwriting and periodically thereafter.	Credit analysis appropriately identifies key risks and is conducted within reasonable timeframes. Analysis after underwriting may need some strengthening.	Credit analysis is deficient. Analysis is superficial and key risks are overlooked. Credit data is not reviewed in a timely manner.
Internal or outsourced risk rating and problem loan identification systems are accurate and timely. They effectively stratify credit risk in both problem and pass-rated credits. They serve as an effective early warning tool, and support risk-based pricing, ALLL, and capital allocation processes.	Internal or outsourced risk rating and problem loan identification systems are adequate. Though improvement can be achieved in one or more areas, they adequately identify problem and emerging problem credits. The graduation of pass ratings may need to be expanded to facilitate early warning; risk-based pricing or capital allocation.	Internal or outsourced risk rating and problem loan identification systems are deficient and require improvement. Problem credits may not be identified accurately or in a timely manner; as a result, portfolio risk is likely misstated. The graduation of pass ratings is insufficient to stratify risk in pass credits for early warning or other purposes (loan pricing, ALLL, capital allocation).
Special mention ratings do not indicate any management problems administering the loan portfolio.	Special mention ratings generally do not indicate management problems administering the loan portfolio.	Special mention ratings indicate management is not properly administering the loan portfolio.

Quality of credit risk management - continued

Strong	Satisfactory	Weak
Management information systems (MIS) provide accurate, timely and complete portfolio information. Management and the board receive appropriate reports to analyze and understand the bank's credit risk profile. MIS facilitates exception reporting, and MIS infrastructure can support ad hoc queries in a timely manner.	Management information systems may require modest improvement in one or more areas, but management and the board generally receive appropriate reports to analyze and understand the bank's credit risk profile. MIS facilitates exception reporting, and MIS infrastructure can support ad hoc queries in a timely manner.	Management information systems have deficiencies requiring attention. The accuracy and/or timeliness of information may be affected in a material way. Portfolio risk information may be incomplete. As a result, management and the board may not be receiving appropriate or sufficient information to analyze and understand the banks credit risk profile. Exception reporting requires improvement, and MIS infrastructure may not support ad hoc queries in a timely manner.
Diversification management is active and effective. Concentration limits are set at reasonable levels. The bank identifies and reports concentrated exposures and initiates actions to limit, reduce or otherwise mitigate their risk. Management identifies and understands correlated exposure risks.	Diversification management may be improved but is adequate. Concentrated exposures are identified, and reported, but limits or other action/exception triggers may be lacking. Management may initiate actions to limit or mitigate concentrations at the individual loan level, but portfolio level actions may be lacking. Correlated exposures may not be identified.	Diversification management is passive or otherwise deficient. Bank may not identify concentrated exposures, and/or identifies them but takes little or no risk limiting, reducing or mitigating action. Management does not understand exposure correlations. Concentration limits, if any, may be exceeded or are frequently raised.
Management is effective. Loan management and personnel possess sufficient expertise to effectively administer the risk assumed. Responsibilities and accountability are clear, and appropriate remedial or corrective action is taken when they are breached.	Management is adequate to administer assumed risk, but improvements may be achieved in one or more areas. Loan management and personnel generally possess the expertise required to effectively administer assumed risks, but additional expertise may be required in one or more areas. Responsibilities and accountability may require some clarification. Generally appropriate remedial or corrective action is taken when they are breached.	Management is deficient. Loan management and personnel may not possess sufficient expertise and/or experience to effectively administer the risk assumed. Responsibilities and accountability may not be clear. Remedial or corrective actions are insufficient to address root causes of problems.
There is a clear, sound credit culture. The board and management's tolerance for risk is well-communicated and fully understood.	The intent of the credit culture is generally understood, but the culture and risk tolerances may not be clearly communicated or uniformly implemented throughout the institution.	Credit culture is lacking or is flawed in a material way. Risk tolerances may not be well understood.

Quality of credit risk management - continued

Strong	Satisfactory	Weak
Strategic and/or business plans are consistent with a conservative risk appetite and promote an appropriate balance between risk-taking and growth and earnings objectives. New products/initiatives are well-researched, tested, and approved before implementation.	Strategic and/or business plans are consistent with a moderate risk appetite. Anxiety for income may lead to some higher risk transactions. Generally there is an appropriate balance between risk-taking and growth and earnings objectives. New products/initiatives may be launched without sufficient testing, but risks are usually understood.	Strategic and/or business plans encourage taking on immoderate levels of risk. Anxiety for income dominates planning activities. Bank engages in new products/initiatives without conducting sufficient due diligence.
Staffing levels and expertise are appropriate for the size and complexity of the loan portfolio. Staff turnover is reasonable and allows for the orderly transfer of responsibilities. Training programs facilitate on-going staff development.	Staffing levels and expertise are generally adequate for the size and complexity of the loan portfolio. Staff turnover is moderate and may create some gaps in portfolio management. Training initiatives may be inconsistent.	Staffing levels are inadequate in numbers or skill level. Turnover is high. Bank does not provide sufficient resources for staff training.
Loan management and personnel compensation structures provide appropriate balance between loan/revenue production, loan quality, and portfolio administration, including risk identification.	Loan management and personnel compensation structures provide reasonable balance between loan/revenue production, loan quality and portfolio administration.	Loan management and personnel compensation structures are skewed to loan/revenue production. There is little evidence of substantive incentives and/or accountability for loan quality and portfolio administration.

Interest Rate Risk

Interest rate risk is the current and prospective risk to earnings or capital arising from movements in interest rates. Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (repricing risk), from changing rate relationships among different yield curves affecting bank activities (basis risk), from changing rate relationships across the spectrum of maturities (yield curve risk), and from interest-related options embedded in bank products (options risk).

Summary Conclusions:

The quantity of interest rate risk is:

☐ Low	☐ Moderate	☐ High

The quality of interest rate risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

Examiners should consider both the quantity of interest rate risk and the quality of interest rate risk management to derive the following conclusions:

Aggregate interest rate risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of interest rate risk indicators

Examiners should use the following indicators, as appropriate, when assessing the quantity of interest rate risk. It is not necessary to exhibit every characteristic in a column, or a majority of the characteristics, to be accorded the rating at the column's head.

Low	Moderate	High
No significant mismatches on longer-term positions exist. Shorter- term exposures are simple and easily adjusted to control risk.	Mismatches on longer-term positions exist but are manageable and could be effectively hedged.	Repricing mismatches are longer-term, and may be significant, complex, or difficult to hedge.
The potential exposure to earnings and capital is negligible under a +/- 200 basis point rate change over a 12-month horizon.	The potential exposure to earnings and capital is not material under a +/- 200 basis point rate change over a 12-month time horizon.	The potential exposure to earnings and capital is significant under a +/- 200 basis point rate change over a 12-month time horizon.
There is little or no exposure to multiple indexes that price assets & liabilities, such as prime, Libor, CMT, COFI, etc.[22]	The potential exposure to multiple indexes that price assets & liabilities, such as prime, Libor, CMT, COFI, etc., is reasonable and manageable.	The potential exposure to multiple indexes that price assets & liabilities, such as prime, Libor, CMT, COFI, etc., is significant. Positions may be complex.
Potential exposure to changes in the yield curve level and shape is absent or negligible.	Potential exposure to changes in the level and shape of the yield curve is not material and considered manageable.	Potential exposure to changes in the level and shape of the yield curve is significant. Positions may be complex.
The potential exposure to assets and/or liabilities with embedded options is low. Positions are neither meaningful nor complex.	The potential exposure to assets and/or liabilities with embedded options is not material. The impact of exercising options is not projected to adversely impact earnings or capital.	The potential exposure to assets and/or liabilities with embedded options is material. Positions may be complex and the impact of exercising options may adversely impact earnings or capital.
The volume and complexity of servicing assets is either insignificant or nonexistent, presenting virtually no exposure to changes in interest rates.	The volume and complexity of servicing assets is relatively modest and does not present material exposure to earnings and capital due to changes in interest rates.	The volume and complexity of servicing assets is material and potentially exposes earnings and capital to significant exposure from changes in interest rates.
The support provided by low-cost, stable nonmaturity deposits is significant and absorbs or offsets exposure arising from longer-term repricing mismatches or options risk.	The support provided by low-cost, stable nonmaturity deposits absorbs some, but not all, of the exposure associated with longer-term repricing mismatches or options risk.	The support provided by low-cost, stable nonmaturity deposits is not significant or sufficient to offset risk from longer-term repricing mismatches or options risk

[22] CMT - Constant Maturity Treasury, COFI - Cost of Funds Index

Quality of interest rate risk management

Examiners should use the following indicators, as appropriate, when assessing the quality of interest rate risk management.

Strong	Satisfactory	Weak
Board-approved policies are sound and effectively communicate guidelines for management of IRR, functional responsibilities, and risk tolerance.	Board-approved policies adequately communicate guidelines for management of IRR, functional responsibilities, and risk tolerance. Minor weaknesses may be evident.	Board-approved policies are inadequate in communicating guidelines for management of IRR, functional responsibilities, and risk tolerance.
Management demonstrates a thorough understanding of IRR. Management anticipates and responds appropriately to adverse conditions or changes in economic conditions.	Management demonstrates an adequate understanding of IRR and generally responds appropriately to adverse conditions or changes in economic conditions.	Management either does not demonstrate an understanding of IRR, or does not anticipate or respond appropriately to adverse conditions or changes in economic conditions.
Risk measurement processes are appropriate given the size and complexity of the bank's on- and off-balance-sheet exposures. Data input processes are effective and ensure the accuracy and integrity of management information. Assumptions are reasonable and well documented. IRR is measured over a wide range of rate movements to identify vulnerabilities and stress points.	Risk measurement processes are appropriate given the size and complexity of the bank's on- and off-balance-sheet exposures. Data input processes are adequate and ensure the accuracy and integrity of management information. Assumptions are reasonable. IRR is measured over an adequate range of rate movements to identify vulnerabilities and stress points. Minor enhancements may be needed.	Risk measurement processes are deficient given the size and complexity of the bank's on- and off-balance-sheet exposures. Material weaknesses may exist in data input and interest rate scenario measurement processes. Assumptions may not be realistic or supported. Deficiencies may be material.
Earnings-at-risk is measured as well as economic value-at-risk when significant longer-term or options risk exposure exists. No weaknesses are evident.	Earnings-at-risk is measured as well as economic value-at-risk when significant longer-term or options risk exposure exists. Minor enhancements may be needed.	Earnings-at-risk may not be appropriately measured. Economic value-at-risk may not be considered despite significant exposure to longer-term or options risk.
Risk limit structures provide clear risk parameters for risk to earnings and economic value consistent with the risk tolerance of the board. Limits reflect sound understanding of risk under adverse rate scenarios.	Risk limit structures for earnings and economic value are reasonable and consistent with the risk tolerance of the board.	Risk limit structures to control risk to earnings and economic value may be absent, ineffective, unreasonable or inconsistent with the risk tolerance of the board.

Quality of interest rate risk management - continued

Strong

Management information systems provide timely, accurate, and complete information on IRR to appropriate levels in the bank. No weaknesses are evident.

A well-designed, independent, and competent review function has been implemented to periodically validate and test the effectiveness of risk measurement systems. The process assesses the reasonableness and validity of scenarios and assumptions. The system is effective and no corrective actions are required.

Satisfactory

Management information systems are adequate, and provide complete information on IRR to appropriate levels of management. Minor weaknesses may be evident.

An acceptable review function is in place. The review periodically validates and tests the effectiveness of risk measurement systems including the reasonableness and validity of scenarios and assumptions. The review is independent and competent. Minor weaknesses may exist, but can be easily corrected.

Weak

Management information systems are inadequate or incomplete. Remedial actions will be necessary, as material weaknesses in MIS are evident.

A review function to periodically validate and test the effectiveness of risk measurement systems either does not exist or is inadequate in one or more material respects. The review may not be independent or completed by competent staff. Processes to evaluate the reasonableness and validity of rate scenarios and assumptions used may be absent or deficient.

Liquidity Risk

Liquidity risk is the current and prospective risk to earnings or capital arising from a bank's inability to meet its obligations when they come due without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources. Liquidity risk also arises from the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

Summary Conclusions:

The quantity of liquidity risk is:

☐ Low	☐ Moderate	☐ High

The quality of liquidity risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

Examiners should consider both the quantity of liquidity risk and the quality of liquidity risk management to derive the following conclusions:

Aggregate liquidity risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of liquidity risk indicators

Examiners should use the following indicators, as appropriate, when assessing the quantity of liquidity risk. It is not necessary to exhibit every characteristic in a column, or a majority of the characteristics, to be accorded the rating at the column's head.

Low	Moderate	High
Funding sources are abundant and provide a competitive cost advantage.	Sufficient funding sources are available which provide cost-effective liquidity.	Funding sources and liability structures suggest current or potential difficulty in maintaining long-term and cost-effective liquidity.
Funding is widely diversified. There is little or no reliance on wholesale funding sources or other credit-sensitive funds providers.	Funding is generally diversified, with a few providers that may share common objectives and economic influences, but no significant concentrations. A modest reliance on wholesale funding may be evident.	Borrowing sources may be concentrated in a few providers or providers with common investment objectives or economic influences. A significant reliance on wholesale funds is evident.
Market alternatives exceed demand for liquidity, with no adverse changes expected.	Market alternatives are available to meet demand for liquidity at reasonable terms, costs, and tenors. The liquidity position is not expected to deteriorate in the near term.	Liquidity needs are increasing, but sources of market alternatives at reasonable terms, costs, and tenors are declining.
Capacity to augment liquidity through asset sales and /or securitization is strong and the bank has an established record in accessing these markets.	Bank has the potential capacity to augment liquidity through asset sales and /or securitization, but has little experience in accessing these markets.	The bank exhibits little capacity or potential to augment liquidity through asset sales or securitization. A lack of experience accessing these markets or unfavorable reputation may make this option questionable.
The volume of wholesale liabilities with embedded options is low.	Some wholesale funds contain embedded options, but potential impact is not significant.	Material volumes of wholesale funds contain embedded options. The potential impact is significant.
The bank is not vulnerable to funding difficulties should a material adverse change occur in market perception.	The bank is not excessively vulnerable to funding difficulties should a material adverse change occur in market perception.	The bank's liquidity profile makes it vulnerable to funding difficulties should a material adverse change occur.
Support provided by the parent company is strong.	Parent company provides adequate support.	Little or unknown support provided by the parent company.
Earnings and capital exposure from the liquidity risk profile is negligible.	Earnings or capital exposure from the liquidity risk profile is manageable.	Potential exposure to loss of earnings or capital due to high liability costs or unplanned asset reduction may be substantial.

Quality of liquidity risk management

Examiners should use the following indicators, as appropriate, when assessing the quality of liquidity risk management.

Strong	Satisfactory	Weak
Board-approved policies effectively communicate guidelines for liquidity risk management and designate responsibility.	Board-approved policies adequately communicate guidance for liquidity risk management and assign responsibility. Minor weaknesses may be present.	Board-approved policies are inadequate or incomplete. Policy is deficient in one or more material respects.
The liquidity risk management process is effective in identifying, measuring, monitoring, and controlling liquidity risk. Reflects a sound culture that has proven effective over time.	The liquidity risk management process is generally effective in identifying, measuring, monitoring, and controlling liquidity. There may be minor weaknesses given the complexity of the risks undertaken, but these are easily corrected.	The liquidity risk management process is ineffective in identifying, measuring, monitoring, and controlling liquidity risk. This may be true in one or more material respects, given the complexity of the risks undertaken.
Management fully understands all aspects of liquidity risk. Management anticipates and responds well to changing market conditions.	Management reasonably understands the key aspects of liquidity risk. Management adequately responds to changes in market conditions.	Management does not fully understand, or chooses to ignore, key aspects of liquidity risk. Management does not anticipate or take timely or appropriate actions in response to changes in market conditions.
The contingency funding plan is well-developed, effective and useful. The plan incorporates reasonable assumptions, scenarios, and crisis management planning, and is tailored to the needs of the institution.	The contingency funding plan is adequate. The plan is current, reasonably addresses most relevant issues, and contains an adequate level of detail including multiple scenario analysis. The plan may require minor refinement.	The contingency funding plan is inadequate or nonexistent. Plan may exist, but is not tailored to the institution, is not realistic, or is not properly implemented. The plan may not consider cost-effectiveness or availability of funds in a non-investment grade or CAMELS "3" environment.
Management information systems focus on significant issues and produce timely, accurate, complete, and meaningful information to enable effective management of liquidity.	Management information systems adequately capture concentrations and rollover risk, and are timely, accurate, and complete. Recommendations are minor and do not impact effectiveness.	Management information systems are deficient. Material information may be lacking or inaccurate, and reports are not meaningful.
Internal audit coverage is comprehensive and effective. The scope and frequency are reasonable.	Internal audit is satisfactory. Any weaknesses are minor and do not impair effectiveness or reliance on audit findings.	Internal audit coverage is nonexistent or ineffective due to one or more material deficiencies.

Price Risk

Price risk is the risk to earnings or capital arising from changes in the value of traded portfolios of financial instruments. This risk arises from market-making, dealing, and position-taking in interest rate, foreign exchange, equity, and commodities markets.

Summary Conclusions:

The quantity of price risk is:

☐ Low	☐ Moderate	☐ High

The quality of price risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

Examiners should consider both the quantity of price risk and the quality of price risk management to derive the following conclusions:

Aggregate price risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of price risk indicators

Examiners should use the following indicators, as appropriate, when assessing the quantity of price risk. It is not necessary to exhibit every characteristic in a column, or a majority of the characteristics, to be accorded the rating at the column's head.

Low	Moderate	High
Exposures are primarily confined to those arising from customer transactions, and involve liquid and readily manageable products, markets, and levels of activity. Bank does trades back-to-back for customers, taking no or negligible risk positions. No proprietary trading exists. Trading personnel merely execute customer orders. Earnings and capital have no vulnerability to volatility from revaluation requirements.	Trading positions exist only to position securities for sale to customers. No proprietary trading. Open positions are small and involve liquid instruments that allow for easy hedging. Limited trading in option-type products. Earnings and capital have limited vulnerability to volatility from revaluation requirements.	Trading activity includes proprietary transactions, with positions unrelated to customer activity. Exposures reflect open or unhedged positions, including illiquid instruments, options and/or longer maturities, which subject earnings and capital to significant volatility from revaluation requirements.
Policy limits reflect no appetite for price risk. Customer sales activities pose no or negligible threat to earnings and capital.	Policy limits reflect limited appetite for price risk.	Policy limits permit risk-taking, with the bank willing to risk losses that can impact quarterly earnings and/or capital.
Daily trading losses do not occur, because bank takes no or negligible risk.	Daily trading losses occur infrequently, and are small. Quarterly trading losses do not occur because of limited risk appetite and emphasis on customer revenues.	Daily trading losses occur periodically because the bank either lacks customer transaction revenue support, or takes positions that can create losses that eclipse customer revenues. Quarterly trading profits, and losses, can be large relative to budget and may occasionally result in a negative public perception.
Bank has a sales-driven culture, with sales personnel exercising greater authority than traders do. Compensation programs reward sales volumes.	Compensation programs reflect sales orientation, but do provide limited incentives for trading profits.	Trader-dominated operation, where compensation programs reward traders for generating trading profits.

Quality of price risk management

Examiners should use the following indicators, as appropriate, when assessing the quality of price risk management.

Strong	Satisfactory	Weak
Policies reflect board's risk appetite, and provide clear authorities, conservative limits, and assigned responsibilities. Policies permit risk-taking authority consistent with the expertise of bank personnel.	Policies provide generally clear authorities, reasonable limits, and assignment of responsibilities. Risk-taking authority is generally consistent with expertise of bank personnel.	Policies reflect management preferences for risk tolerance, as opposed to the board. Policies do not clearly assign responsibilities. Risk-taking authority does not reflect the expertise of trading personnel.
Management reports are prepared independently of the trading desk and provide a comprehensive and accurate summary of trading activities. Reports are timely, assess compliance with policy limits, and measure loss potential in both normal (e.g., VaR) and stressed markets. Management at all levels understands and monitors price risk.	Management reports are prepared independently of the trading desk, and provide a general summary of trading activities. Reports are timely, but may not fully assess loss potential. Trading unit management reviews risk reports, but management at higher levels may lack the understanding to review it on a frequent basis and in depth.	Management reports are not independent of the trading desk, do not provide risk-focused information, and may not be prepared regularly. Higher level managers do not understand price risk and do not review risk management reports.
Trading and sales personnel have broad experience in the products traded, are technically competent, and are comfortable with the bank's culture. Risk management personnel have an in-depth understanding of risk and risk management principles. Policy exceptions are rare, and formal procedures exist to report how/why they occurred, and how they were resolved.	Trading and sales personnel are generally experienced and technically competent. Risk management personnel, if the bank has such a unit, have a basic understanding of risk and risk management principles. Policy exceptions occur occasionally, but the bank may lack a formal process to report them and track resolution.	Trading and sales personnel may not have broad experience in the products they trade. A risk management unit does not exist, or is not independent and staffed by personnel familiar with risk management principles. Policy exceptions regularly occur and may not be reported or tracked for resolution.
New products are subject to a formal review program, with all relevant bank units participating in risk assessment and control procedures. Trading and sales authorizations for new products begin small, so that the bank can gain experience, and management tracks new product performance closely.	New products are subject to a formal review program, but relevant bank units may, or may not, assess their ability to properly control the activity. Trading and sales authorizations generally begin small. Management may, or may not, focus on new product performance.	Bank lacks a new product review program, or has one that assesses risk in a cursory way. Trading and sales authorizations are independent of risk and/or the expertise of the traders. Management does not specifically focus on new product performance.
Incompatible duties are properly segregated. Risk monitoring, valuation, and control functions are independent from the business unit.	Incompatible duties are generally segregated. Risk monitoring and control functions may not exist, or lack complete independence from the business unit.	Incompatible duties are often not segregated. Risk control functions do not exist, or are not independent from the business unit. Trading positions are frequently valued on trader prices, with limited independent verification.

Foreign Currency Translation Risk

Foreign currency translation risk is the current and prospective risk to earnings or capital arising from the conversion of a bank's financial statements from one currency into another. This risk refers to the variability in accounting values for a bank's equity accounts that result from variations in the exchange rates used in translating carrying values and income streams in foreign currencies to U.S. dollars. Market-making and position-taking in foreign currencies should be captured under price risk.

Summary Conclusions:

The quantity of foreign currency translation risk is:

☐ Low	☐ Moderate	☐ High

The quality of foreign currency translation risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

Examiners should consider both the quantity of foreign currency translation risk and the quality of foreign currency translation risk management to derive the following conclusions:

Aggregate foreign currency translation risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of foreign currency translation risk indicators

Examiners should use the following indicators, as appropriate, when assessing the quantity of foreign currency translation risk.

Low	Moderate	High
The bank has non-dollar-denominated positions that are completely hedged. Assets denominated in foreign currencies equal liabilities denominated in foreign currencies. Earnings and capital are not vulnerable to changes in foreign currency exchange rates.	Bank may have a small volume of unhedged, non-dollar denominated positions, but it can readily hedge at a reasonable cost. Limited vulnerability to changes in foreign currency exchange rates.	Exposure reflects a large volume of unhedged, non-dollar denominated positions, or a smaller volume of unhedged positions in illiquid currencies for which hedging can be expensive. Changes in foreign currency exchange rates can adversely impact earnings and capital.

Quality of foreign currency translation risk management

Examiners should use the following indicators, as appropriate, when assessing the quality of foreign currency translation risk management.

Strong	Satisfactory	Weak
Policies clearly and reasonably limit the volume of translation risk and assigned responsibilities.	Policies address translation risk in a general way, but may not provide specific management guidelines.	The bank does not have a policy addressing translation risk or policy limits are not reasonable given management expertise, the bank's capital position, and /or volume of assets and liabilities denominated in foreign currencies. Responsibilities are not clearly assigned.
Management effectively understands, can measure, and has technical expertise in managing translation risk.	Management has a reasonable understanding of translation risk as well as of how to measure and hedge it.	Management does not demonstrate an understanding of translation risk, and lacks the ability to manage it effectively.
Management and the board regularly review currency translation risk exposures and direct changes, if necessary, given market conditions and the size of the exposure.	Management and the board regularly review translation risk exposures, but generally don't direct changes even in unsettled markets.	Neither management nor the board is aware of the magnitude of translation risk or does not review reports outlining translation risks.

Transaction Risk

Transaction risk is the current and prospective risk to earnings and capital arising from fraud, error, and the inability to deliver products or services, maintain a competitive position, and manage information. Risk is inherent in efforts to gain strategic advantage and in the failure to keep pace with changes in the financial services marketplace. Transaction risk is evident in each product and service offered. Transaction risk encompasses product development and delivery, transaction processing, systems development, computing systems, complexity of products and services, and the internal control environment.

Summary Conclusions:

The quantity of transaction risk is:

☐ Low	☐ Moderate	☐ High

The quality of transaction risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

Examiners should consider both the quantity of transaction risk and the quality of transaction risk management to derive the following conclusions:

Aggregate transaction risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of transaction risk indicators

Examiners should use the following indicators when assessing the quantity of transaction risk.

Low	Moderate	High
Exposure to risk from fraud, errors, or processing disruptions is minimal given the volume of transactions, complexity of products and services, and state of systems development. Risk to earnings and capital is negligible.	Exposure to risk from fraud, errors, or processing disruptions is modest given the volume of transactions, complexity of products and services, and state of systems development. Deficiencies that have potential impact on earnings or capital can be addressed in the normal course of business.	Exposure to risk from fraud, errors, or processing disruptions is significant given the volume of transactions, complexity of products and services, and state of systems development. Deficiencies exist which represent significant risk to earnings and capital.
Risks, including transaction processing failures, from planned conversions, merger integration, or new products and services are minimal.	Risks, including transaction processing failures, from planned conversions, merger integration, or new products and services are manageable.	Risks, including transaction processing failures, from planned conversions, merger integration, or new products and services are substantial.

Quality of transaction risk management

Examiners should use the following indicators when assessing the quality of transaction risk management.

Strong	Satisfactory	Weak
Management anticipates and responds effectively to risks associated with operational changes, systems development, and emerging technologies.	Management adequately responds to risks associated with operational changes, systems development, and emerging technologies.	Management does not take timely and appropriate actions to respond to operational changes, systems development, or emerging technologies.
Management has implemented sound operating processes, information systems, internal control, and audit coverage.	Operating processes, information systems, internal control, and audit coverage are satisfactory although deficiencies exist.	Significant weaknesses exist in operating processes, information systems, internal control, or audit coverage related to transaction processing.
Management identifies weaknesses in transaction processing and takes timely and appropriate action.	Management recognizes weaknesses in transaction processing and generally takes appropriate action.	Management does not recognize weaknesses in transaction processing or make the necessary corrections.
Management information provides appropriate monitoring of transaction volumes, error reporting, fraud, suspicious activity, security violations, etc. MIS is accurate, timely, complete and reliable.	Management information systems for transaction processing are adequate, although moderate weaknesses may exist.	Management information systems for transaction processing exhibit significant weaknesses or may not exist.
Management comprehensively provides for continuity and reliability of services, including services furnished by outside providers.	Management adequately provides for continuity and reliability of significant services furnished by outside providers.	Management has not provided for continuity and reliability of services furnished by outside providers.
Appropriate processes and controls exist to manage and protect data.	Processes and controls to manage and protect data may have modest deficiencies.	Processes and controls to manage and protect data are seriously deficient or nonexistent.
Risks from new products and services, planned strategic initiatives, or acquisitions are well controlled and understood.	Management has implemented controls that mitigate risks from new products and services, planned strategic initiatives, or acquisitions.	Inadequate planning or due diligence expose the bank to significant risk from activities such as the introduction of new products and services, strategic initiatives, or acquisitions.
Management fully understands technology risks with available expertise to evaluate technology-related issues.	Management reasonably understands technology risks and has expertise available to evaluate technology-related issues.	Management does not understand, or has chosen to ignore, key aspects of transaction risk.

Compliance Risk

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards. Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of the bank's clients may be ambiguous or untested. This risk exposes the institution to fines, civil money penalties, payment of damages, and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential, and an inability to enforce contracts.

Summary Conclusions:

The quantity of compliance risk is:

☐ Low	☐ Moderate	☐ High

The quality of compliance risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

Examiners should consider both the quantity of compliance risk and the quality of compliance risk management to derive the following conclusions:

Aggregate compliance risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of compliance risk indicators

Examiners should use the following indicators when assessing the quantity of compliance risk.

Low	Moderate	High
Violations or noncompliance issues are insignificant, as measured by their number or seriousness.	The frequency or severity of violations or noncompliance is reasonable.	Violations or noncompliance expose the company to significant impairment of reputation, value, earnings, or business opportunity.
The institution has a good record of compliance. The bank has a strong control structure that has proven effective. Compliance management systems are sound and minimize the likelihood of excessive or serious future violations or noncompliance.	The institution has a satisfactory record of compliance. Compliance management systems are adequate to avoid significant or frequent violations or noncompliance.	The institution has an unsatisfactory record of compliance. Compliance management systems are deficient, reflecting an inadequate commitment to risk management.

Quality of compliance risk management indicators

Examiners should use the following indicators when assessing the quality of compliance risk management.

Strong	Satisfactory	Weak
Management fully understands all aspects of compliance risk and exhibits a clear commitment to compliance. The commitment is communicated throughout the institution.	Management reasonably understands the key aspects of compliance risk. Its commitment to compliance is reasonable and satisfactorily communicated.	Management does not understand, or has chosen to ignore, key aspects of compliance risk. The importance of compliance is not emphasized or communicated throughout the organization.
Authority and accountability for compliance are clearly defined and enforced.	Authority and accountability are defined, although some refinements may be needed.	Management has not established or enforced accountability for compliance performance.
Management anticipates and responds well to changes of a market, technological, or regulatory nature.	Management adequately responds to changes of a market, technological, or regulatory nature.	Management does not anticipate or take timely or appropriate actions in response to changes of a market, technological, or regulatory nature.
Compliance considerations are incorporated into product and system development and modification processes, including changes made by outside service providers or vendors.	While compliance may not be formally considered when developing products and systems, issues are typically addressed before they are fully implemented.	Compliance considerations are not incorporated into product and system development.
When deficiencies are identified, management promptly implements meaningful corrective action.	Problems can be corrected in the normal course of business without a significant investment of money or management attention. Management is responsive when deficiencies are identified.	Errors are often not detected internally, corrective action is often ineffective, or management is unresponsive.
Appropriate controls and systems are implemented to identify compliance problems and assess performance.	No shortcomings of significance are evident in controls or systems. The probability of serious future violations or noncompliance is within acceptable tolerance.	The likelihood of continued violations or noncompliance is high because a corrective action program does not exist, or extended time is needed to implement such a program.
Training programs are effective, and the necessary resources have been provided to ensure compliance.	Management provides adequate resources and training given the complexity of products and operations.	Management has not provided adequate resources or training.
Compliance management process and information systems are sound, and the bank has a strong control culture that has proven effective.	Compliance management process and information systems are adequate to avoid significant or frequent violations or noncompliance.	Compliance management processes and information systems are deficient.
Bank privacy policies fully consider legal and litigation concerns.	Bank privacy policies adequately consider legal and litigation concerns.	Bank privacy policies are nonexistent or do not consider legal and litigation concerns.

Strategic Risk

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.

Summary Conclusions:

Aggregate strategic risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Strategic risk indicators

Examiners should use the following indicators when assessing the aggregate level of strategic risk.

Low	Moderate	High
Risk management practices are an integral part of strategic planning.	The quality of risk management is consistent with the strategic issues confronting the organization.	Risk management practices are inconsistent with strategic initiatives. A lack of strategic direction is evident.
Strategic goals, objectives, corporate culture, and behavior are effectively communicated and consistently applied throughout the institution. Strategic direction and organizational efficiency are enhanced by the depth and technical expertise of management	Management has demonstrated the ability and technical expertise to implement goals and objectives, and successful implementation of strategic initiatives is likely.	Strategic initiatives are inadequately supported by the operating policies and programs that direct behavior. The structure and managerial and/or technical talent of the organization do not support long-term strategies.
Management has been successful in accomplishing past goals and is appropriately disciplined.	Management has a reasonable record in decision making and controls.	Deficiencies in management decision-making and risk recognition do not allow the institution to effectively evaluate new products, services, or acquisitions.
Management information systems effectively support strategic direction and initiatives.	Management information systems reasonably support the company's short-term direction and initiatives.	Management information systems supporting strategic initiatives are seriously flawed or do not exist.
Exposure reflects strategic goals that are not overly aggressive and are compatible with developed business strategies.	Exposure reflects strategic goals that are aggressive but compatible with business strategies.	Strategic goals emphasize significant growth or expansion that is likely to result in earnings volatility or capital pressures.
Initiatives are well conceived and supported by appropriate communication channels, operating systems, and service delivery networks. The initiatives are well supported by capital for the foreseeable future and pose only nominal possible effects on earnings volatility.	The corporate culture has only minor inconsistencies with planned initiatives. The initiatives are reasonable considering the capital, communication channels, operating systems, and service delivery networks. Decisions are not likely to have a significant adverse impact on earnings or capital. If necessary, the decisions or actions can be reversed without significant cost or difficulty.	The impact of strategic decisions is expected to significantly affect franchise value. Strategic initiatives may be aggressive or incompatible with developed business strategies, communication channels, operating systems, and service delivery networks. Decisions are either difficult or costly to reverse.
Strategic Initiatives are supported by sound due diligence and strong risk management systems. The decisions can be reversed with little difficulty and manageable costs.	Strategic initiatives will not materially alter business direction, can be implemented efficiently and cost effectively, and are within management's abilities.	Strategic goals are unclear or inconsistent, and have led to an imbalance between the institution's tolerance for risk and willingness to supply supporting resources.

Reputation Risk

Reputation risk is the current and prospective impact on earnings and capital arising from negative public opinion. This affects the institution's ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the institution to litigation, financial loss, or a decline in its customer base. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with its customers and the community.

Summary Conclusions:

Aggregate reputation risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Reputation risk indicators

Examiners should use the following indicators when assessing the aggregate level of reputation risk.

Low	Moderate	High
Management anticipates and responds well to changes of a market or regulatory nature that impact its reputation in the marketplace.	Management adequately responds to changes of a market or regulatory nature that impact the institution's reputation in the marketplace.	Management does not anticipate or take timely or appropriate actions in response to changes of a market or regulatory nature.
Management fosters a sound culture that is well supported throughout the organization and has proven very effective over time.	Administration procedures and processes are satisfactory. Management has a good record of correcting problems. Any deficiencies in management information systems are minor.	Weaknesses may be observed in one or more critical operational, administrative, or investment activities. Management information at various levels exhibits significant weaknesses.
The bank effectively self-polices risks.	The bank adequately self-polices risks.	The institution's performance in self-policing risk is suspect.
Internal control and audit are fully effective.	Internal control and audit are generally effective.	Internal control or audit are not effective in reducing exposure. Management has either not initiated, or has a poor record of, corrective action to address problems.
Franchise value is only minimally exposed by reputation risk. Exposure from reputation risk is expected to remain low in the foreseeable future.	The exposure of franchise value from reputation risk is controlled. Exposure is not expected to increase in the foreseeable future.	Franchise value is substantially exposed by reputation risk shown in significant litigation, large dollar losses, or a high volume of customer complaints. The potential exposure is increased by the number of accounts, the volume of assets under management, or the number of affected transactions. Exposure is expected to continue in the foreseeable future.
Losses from fiduciary activities are low relative to the number of accounts, the volume of assets under management, and the number of affected transactions. The bank does not regularly experience litigation or customer complaints.	The bank has avoided conflicts of interest and other legal or control breaches. The level of litigation, losses, and customer complaints are manageable and commensurate with the volume of business conducted.	Poor administration, conflicts of interest, and other legal or control breaches may be evident.
Management has a clear awareness of privacy issues and uses customer information responsibly.	Management understands privacy issues and generally uses customer information responsibly.	Management is not aware and/ or concerned with privacy issues and may use customer information irresponsibly.

Appendix A: Aggregate Risk Matrix

Quality of Risk Management	Quantity of Risk		
	Low	**Moderate**	**High**
Weak	Low to Moderate	Moderate to High	High
Satisfactory	Low	Moderate	Moderate to High
Strong	Low	Low to Moderate	Moderate

Note:

This matrix is a guide to rating aggregate risk. As the matrix indicates, an aggregate rating is a combination of two already assessed ratings — one for the quantity of risk and the other for the quality of risk management. The ratings at the intersects are guides only; examiners should feel free to consider other factors not depicted on this diagram.

Appendix B: Audit Ratings Guidance

Examiners should consider the following key attributes when assessing the quality of a bank's overall audit program. It is not necessary for the audit program to meet every attribute to be accorded a specific rating of strong, satisfactory, or weak. These key attributes are normally present to distinguish between ratings, but examiners will need to factor in the bank's size, the nature of its activities, and its risk profile to arrive at an overall rating.

Strong

Overall, a **strong** audit program attains the highest level of respect and stature in the organization, which is continually confirmed by management and board attitudes, actions, and support. Audit's role is clearly spelled out and incorporated into overall risk management, new product and service deployment, changes in strategy, and organizational and structural changes.

<u>Board/Audit Committee Oversight</u> — The board, or its committee assigned audit oversight responsibility, is proactive in dealing with management and risk management issues in a timely manner. Reports and information submitted to the board or committee are clear and understandable in their discussions of issues, emerging risks, corrective actions, testing, and resolution of outstanding items. The board or committee maintains dialogue with internal and external auditors, regulators, and management and involves all appropriate groups in discussions on new business ventures, the potential risks involved, and planned controls. The board or committee takes an active role in reviewing and approving the overall annual audit plans, for both internal and external audit engagements, as well as setting expectations for the roles of both internal and external auditors and evaluating their performance under the plan. The use of external auditors is clearly defined in engagement letters.

<u>Audit Management and Processes</u> — Internal audit management possesses industry expertise and knowledge to match the sophistication and complexity of the bank's risk profile and operations. Audit is independent in executing audit plans and audit programs and discussing issues with the board/audit committee and regulators. Audit scopes and report findings are supported by work papers. Internal auditors address control deficiencies in a timely manner and perform thorough follow-up testing to ensure corrective measures are effective. Internal audit plans are completed with minimal carryover or

have appropriately supported amendments based on significant changes in the bank's risk profile.

The internal and external audit processes are fully effective. If any part of the internal audit is outsourced or co-sourced, these duties or assignments are carried out effectively and are managed appropriately by the bank. Audit processes include indicators and descriptions of key risks and controls in place. Management information systems are timely, accurate, complete and reliable.

Responsibilities between audit and other risk management oversight functions are well delineated. If appropriate, risk and frequency models are effectively used, and accurately reflect the risk posed by the bank's activities. Overall audit planning is effective and timely in addressing audit needs for low- and moderate-risk areas. Audit scopes are flexible to the extent of addressing new business lines, products, and activities, and, if appropriate, merger/acquisition situations.

<u>Audit Reporting</u> — Audit reports clearly outline the causes of problems and specifically point out management issues when present. There are few differences between bank-assigned audit assessments and examiner assessments for internal controls. Internal audit ratings, if used, are well defined and are fully effective in identifying areas where control weaknesses exist. Work paper documentation effectively supports the findings presented in the reports and the audit ratings assigned.

<u>Internal Audit Staffing</u> — Audit staffing and experience fully complements the level of risk undertaken by the bank. Staff turnover is minimal and vacancies are promptly addressed and have little or no affect on internal audit plans or processes. Recruitment and training processes are effective. The audit staff possesses a high level of knowledge of the areas audited.

Satisfactory

Overall, a **satisfactory** audit program attains an adequate level of respect and stature in the organization and is generally supported by the actions of management and board. Audit's role in overall risk management and its participation in new product and service deployment, changes in strategy, and organizational and structural changes may be limited, but is conducted effectively.

Board/Audit Committee Oversight — The board or audit committee is effective in their oversight of the audit program. Reports and information presented to the committee provide sufficient information and discussion of significant audit and control issues. The committee holds senior management accountable for issues in their respective business lines. The committee understands the overall audit plans of internal audit and the engagement of external auditors and the respective roles to be performed by both internal and external auditors. The use of external auditors is clearly defined in engagement letters.

Audit Management and Processes — Internal audit management generally possesses the knowledge and experience to ensure adequate internal audit operations appropriate for the bank's size, activities, and risk profile. For small community banks, the lack of internal audit management independence is mitigated by effective internal controls. Internal audits and follow-up are timely, comprehensive, independent, and effective in assessing and monitoring controls. Audit programs, processes, and information systems are generally sound, and complement the control and risk management environment. Audit policies are generally effective, adhered to, and appropriate for the bank's size, complexity, and risk profile. If any internal audit duties or assignments are outsourced or co-sourced, the bank manages these duties adequately.

Audit Reporting — Internal audit reports are clear, concise, and accurately reflect reviews of the area and the root causes of issues. Bank assigned internal audit ratings, if used, or assessments are adequately defined. Conclusion or assessment differences with examination findings may exist, but do not compromise the overall audit program. Internal audit work papers and programs support findings and conclusions.

Internal Audit Staffing — Audit staff is generally competent and experienced. The audit staff may have experienced some turnover and vacancies, but not to the extent of compromising internal audit plans and processes. Staff training is adequate.

Weak

Overall, a **weak** audit program is one that is not an integral part of the organization. The audit program does not have the full support of the board and management. Audit's role is unclear and not utilized in overall risk management, new product and service deployment, changes in strategy, and organizational and structural changes.

Audit Committee — The audit committee (or board if there is no committee) is not effective in their oversight of the audit program. Reports and information submitted to the board or committee are insufficient or not fully understood. The board or committee fails to follow-up on control and risk weaknesses noted by audit or to hold senior management accountable for issues in their respective business lines. The board or committee has a passive role in the overall audit plan or selection of the external audit engagement and is not involved in determining the respective roles of the internal and external auditors. Engagement letters describing the work to be performed by the external auditors are non-existent, incomplete, or not understood.

Audit Management and Processes — Weaknesses exist in internal audit management and processes, such as lack of competence or independence or inadequate scope of review, that are not mitigated by strong internal controls. Audit policies may exist, but need significant enhancements in light of the bank's size, complexity, and risk profile. Audit programs, processes, reports, and information systems are generally ineffective in addressing significant control or risk issues. If any part of the internal audit is outsourced or co-sourced, these duties or assignments are not carried out effectively or the bank does not managed them appropriately.

Audit Reporting — Internal audit rating or assessment definitions are loosely defined or nonexistent. Audit reports are unclear and do not reflect accurate conclusions or fully identify the root causes of concerns. Significant conclusion or assessment differences exist with examination findings. Internal audit program work papers, in many cases, are insufficient or do not support findings and conclusions.

Internal Audit Staffing — Audit staff is inexperienced or lacks adequate knowledge. The internal audit area is understaffed or suffers from high turnover significantly affecting internal audit plans and processes. Management has failed to maintain the staff levels needed to fully support the internal audit function. Staff training is inadequate.

Appendix C: Standard Request Letter

Note: This enclosure is provided as a guide and should be modified as needed depending on the scope of the examination and the risk profile of the bank. The EIC should also indicate which items should be provided prior to the start of the examination and which will be reviewed during the on-site portion of the examination.

The EIC should discuss the feasibility of obtaining the request letter information in a digital format with bank management during the examination planning. If the bank is able to facilitate providing a digital format, the following paragraph should be included in the request letter:

> In order for us to prepare effectively for this examination, we are asking you provide the information listed in the attachment to this request letter in digital format. In instances where this is not possible, we request the data be faxed to a designated number at our office. For larger pieces of hardcopy information, we request that you provide the information by mail. Please indicate whether any hardcopy information needs to be returned.

Management and Supervision

1. The most recent board packet. Any information included in the packet and requested below need not be duplicated.

2. Current organizational chart.

3. If any changes have occurred since the last examination, a list of directors and executive management, and their backgrounds, including work experience, length of service with the bank, etc. Also, a list of committees, including current membership.

4. If any changes have occurred since the last examination, a list of related organizations (e.g., parent holding company, affiliates, and operating subsidiaries).

5. Most recent external audit reports, management letter, engagement letter, and management's responses to findings (including audits of outside service providers, if applicable).

6. (Current year) internal audit schedule, indicating audits completed with summary ratings, and in process.

7. Most recent internal audit reports, including management's responses. Include (prior year) audit reports covering loan administration, funds management and investment activities, risk-based capital computations, information processing and any audit areas that were assigned a less than satisfactory rating.

8. Brief description of new products, services, lines of business, or changes in the bank's market area.

9. List of data processors and other servicers (e.g., loan, investment). The detail of the list should include:
   - Name of servicer
   - Address of servicer
   - Contact name and phone number
   - Brief explanation of the product(s) or service(s) provided.
   - Note of any affiliate relationship with the bank

   For example, services provided may include the servicing of loans sold in whole or in part to other entities, including the service provider. OCC examiners will use this list to request trial balances or other pertinent information not otherwise requested in this letter.

10. Minutes of board and major committee meetings (e.g., Audit, Loan, Asset/Liability Management, and Technology Steering Committee) since our last examination.

Asset Quality

11. List of watch list loans, problem loans, past-due credits, and nonaccrual loans.

12. List of the ten largest loans made since the last examination and the new loan report for the most recent quarter.

13. Most recent concentrations of credit reports.

14. Most recent policy, underwriting, collateral and documentation exception reports.

15. List of insider credits (to directors, executive officers, and principal shareholders) and their related interests. The list should include terms (rates, collateral, structure, etc.).

16. List of loan participations purchased and sold, whole loans purchased and sold, and any securitization activity since the last examination.

17. List of overdrafts.

18. Most recent analysis of the allowance for loan and lease losses including any risk rating changes from the most recent quarter.

19. List of other real estate, repossessed assets, classified investments and cash items.

20. List of small business and farm loans "exempt" from documentation requirements.

21. Latest loan review report, including any responses from the senior lending officer, account officers, etc.

22. List of board-approved changes to the loan policy and underwriting standards since the last examination.

23. The most recent loan trial balance.

24. The bank's loan policy including a description of the bank's risk rating system.

Financial Performance

25. Most recent ALCO package.

26. Most recent reports used to monitor and manage interest rate risk (e.g., gap planning, simulation models, and duration analysis).

27. Most recent liquidity reports (e.g., sources and uses).

28. List of investment securities purchased and sold for (current year) and (prior year). Please include amount, seller/buyer, and date of each transaction.

29. Most current balance sheet and income statement.

30. Most recent strategic plan, budget, variance reports, etc.

31. Current risk-based capital calculation.

32. Securities acquired based upon "reliable estimates" authority in 12 CFR 1.3(i).

33. The pre-purchase analysis for all securities purchased since the last examination.

34. A summary of the primary assumptions used in the IRR measurement process and the source.

35. Current contingency funding plan.

36. Investment portfolio summary trial, including credit ratings.

37. The list of board-approved securities dealers.

38. List of shareholders and ownership.

39. Most recent annual and quarterly shareholders' reports.

Other Areas of Interest

40. Most recent Report of Condition and Income (call report).

41. List of pending litigation, including a description of circumstances behind the litigation.

42. Details regarding the bank's blanket bond and other major insurance policies (including data processing related coverage). Provide name of insurer, amount of coverage and deductible, and maturity. Also, please indicate the date of last board review and whether the bank intends to maintain the same coverage upon maturity.

43. Summary of payments to the holding company and any affiliates.

44. Bank work papers for the most recent call report submitted.

Information Technology Systems

45. List of in-house computer systems and networks. Include equipment vendor, type/version of system, operating system, number of terminals, and major applications accessed/processed. Provide schematics for networks (including local or wide area networks).

46. List of major software applications used by the bank. Include developer (in-house or vendor), individual/company responsible for maintenance, and computer system(s) where application is used. Include PC-based applications or spreadsheets that support the bank's risk-management processes (for example, internally developed gap report).

47. As applicable, contracts, financial analyses, and performance monitoring reports for servicers/vendors listed in #9, 45 or 46 above.

48. Meeting minutes from Information Technology Steering Committee (or similar) since prior examination.

49. Bank and servicer plans for disaster recovery and corporate-wide business recovery including report from most recent disaster recovery test.

50. Reports used to monitor computer activity, network performance, system capacity, security violations, and network intrusion attempts.

51. Bank policies and procedures relating to information processing or information security.

Appendix D: Community Bank Report of Examination

Since 1993, examiners have written examination reports consistent with the interagency uniform common core Report of Examination (ROE) format. Recently, the federal banking agencies agreed to a more flexible approach in writing reports of examination. This appendix outlines how the OCC will implement this new flexibility and supplements Examining Bulletins 93-7, "Interagency Common Core Report of Examination," and 93-9, "Report of Examination."

Specifically, a new streamlined ROE will be used in community banks with total assets of less than $1 billion. For community banks supervised by the Large Bank division, examiners should follow guidance on communications contained in the "Large Bank Supervision" booklet of the *Comptroller's Handbook*.

Examination reports for community banks that have composite ratings of 1 or 2 need only contain the mandatory pages below. Examiners should include additional *supplemental* pages, as appropriate, based on the risk profile of the bank and the results of the examination. If any component rating is 3 or worse, the examiner must use the appropriate narrative page. Other schedules related to that component rating should also be used as needed. In addition, the examiner will use the applicable narrative page when significant supervisory concerns are being communicated, such as unwarranted risk taking, or when the bank being examined has high overall risk profile and supervisory activities are being expanded.

As specified in Examining Bulletin 93-9, the examiner is still required either to complete a separate ROE for targeted examinations of areas such as compliance or asset management or to include the information on the appropriate optional page in the ROE after a full-scope examination.

The uniform common core ROE is still required for:

- Community banks rated composite 3 or worse,
- Community banks with total assets of $1 billion or greater not supervised by the Large Bank division, or
- Community banks that have been in operation less than 3 years.

Mandatory Pages

- **Examination Conclusions and Comments**

  Examiners will discuss the conclusions and recommendations identified during the examination. This page will also include composite and component CAMELS/I ratings, and other regulatory ratings as appropriate. A brief comment should be included to support each rating.

- **Matters Requiring Attention**

  The "Matters Requiring Attention" (MRA) page will be completed when there are significant supervisory issues that require management's attention. When there are no such issues, the examiner is required to insert the word "None" on the MRA page.

- **Management/Administration**

  Examiners will provide an assessment of the bank's board and management supervision, including an assessment of audit and internal controls.

- **Summary of Items Subject to Adverse Classification/Items Listed as Special Mention**

  Examiners will provide a listing of assets subject to adverse classification/special mention.

- **Risk Assessment Summary**

  Examiners will assess the quantity of risk, quality of risk management, aggregate level of risk, and the direction of risk for each risk category using the RAS matrix. A brief narrative comment under the risk matrix will be included for each risk category.

- **Signature of Directors**

  Examiners will include the "Signature of Directors" page from the standard ROE shell.

The following pages become mandatory under the circumstances described below:

- **Concentrations**

  Examiners must complete the "Concentrations" page when concentrations are identified. The concentration data must also be entered into Examiner View.

- **Loans with Structural Weaknesses**

  Examiners must complete the "Loans with Structural Weaknesses" page when loans with structural weaknesses are identified. Currently, the most efficient way to complete the report page is to enter the data through Examiner View.

- **Compliance with Enforcement Actions**

  The "Compliance with Enforcement Actions" page must be completed whenever the bank is under a formal or informal enforcement action.

- **Violations of Laws and Regulations**

  The "Violations of Laws and Regulations" page is required whenever substantive legal and regulatory violations are identified.

Supplemental Pages

Examiners will include supplemental pages if they are relevant to the examination targets and justified by the bank's condition and risk profile. If a component rating is 3 or worse, the examiner must use the applicable narrative page. Other schedules relating to the component rating are not necessarily required but should be used as needed.

What follows is a list of supplemental pages:

- Capital Adequacy
- Asset Quality

- Earnings
- Liquidity – Asset/Liability Management
- Sensitivity to Market Risk
- Comparative Statements of Financial Condition
- Capital Calculations
- Analysis of Earnings
- Information Technology Systems
- Consumer Compliance
- Fair Lending
- Asset Management
- Community Reinvestment Act
- Items Subject to Adverse Classification
- Items Listed for Special Mention
- Credit or Collateral Exceptions
- Loans and Lease Financing Receivables/Past Due and Nonaccural Loans and Leases
- Other Matters
- Additional Information
- Report Abbreviations

References

Note: This section lists some of the references frequently used by examiners to supervise community banks.

Capital

12 USC 56 and 60, Dividends
12 USC 1817(j), 12 CFR 5.50, Control of the Bank
12 CFR 3, Minimum Capital Ratios
OCC Banking Circular 268, "Prompt Corrective Action"

Asset Quality

12 USC 84, 12 CFR 32, Lending Limits
12 CFR 34, Real Estate Lending and Appraisals
OCC Banking Bulletin 93-18, "Interagency Policy on Small Business Loan Documentation"
OCC Banking Circular 181, "Purchases of Loans in Whole or in Part — Participations"
OCC Bulletin 95-7, "Concentration of Credit"
OCC Bulletin 99-10, "Interagency Guidance on Subprime Lending"
OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy"
FAS 66, "Accounting for Sales of Real Estate"
FAS 114, "Accounting for Creditors for Impairment of a Loan"

Management

12 USC 375a & b, 12 CFR 31, 12 CFR 215, Loans to Executive Officers, Directors and Principal Shareholders
12 CFR 30, Safety and Soundness Standards
OCC Bulletin 98-1, "Interagency Policy Statement on Internal Audit and Internal Audit Outsourcing"
OCC Bulletin 99-37, "Interagency Policy Statement on External Auditing Programs"

Earnings

Federal Financial Institutions Examination Council, “Consolidated Reports of Condition and Income — Instructions”

Liquidity and Sensitivity to Market Risk

12 CFR 1, Investment Securities
OCC Banking Circular 127(rev), “Uniform Classification of Assets and Appraisal of Securities”
OCC Banking Circular 277, “Risk Management of Financial Derivatives”
OCC Bulletin 96-36, “Joint Interagency Policy Statement on Interest Rate Risk”
OCC Bulletin 97-9, “Interest Rate Risk”
OCC Bulletin 98-20, “Investment Securities — Policy Statement”
OCC Bulletin 99-2, “Risk Management of Financial Derivatives — BC-277 Supp. 1”
OCC Bulletin 99-46, “Interagency Guidance on Asset Securitization Activities”
OCC Bulletin 2000-16, “Risk Modeling — Model Validation”
FAS 52, “Foreign Currency Translation”
FAS 115, “Accounting for Certain Investments in Debt and Equity Securities”

Information Technology

OCC Advisory Letter 2000-12, “Risk Management of Outsourcing Technology Services”
OCC Banking Circular 226, “End-User Computing”
OCC Banking Circular 229, “Information Security”
OCC Bulletin 97-23, “FFIEC Interagency Statement on Corporate Business Resumption and Contingency Planning”
OCC Bulletin 98-3, “Technology Risk Management — Guide for Bankers and Examiners”
OCC Bulletin 98-38, “Technology Risk Management: PC Banking Guidance for Bankers and Examiners”
OCC Bulletin 2001-18, “Guidelines Establishing Standards for Safeguarding Customer Information”
Federal Financial Institutions Examination Council, “Information Systems Examination Handbook”

Other

OCC Bulletin 96-18, “ National Bank Appeals Process”
OCC Bulletin 98-46, “Uniform Interagency Trust Rating System”
OCC Bulletin 99-3, “Uniform Rating System for Information Technology”
PPM 5000-34, “Canary Early Warning System”
PPM 5400-8 (rev), “Supervision Work Papers”
PPM 5400-9, “De Novo and Converted Banks”

Comptroller’s Handbook

“Accounts Receivable and Inventory Financing”
“Agricultural Lending”
“Allowance for Loan and Lease Losses”
“Asset Management”
“Asset Securitization”
“Bankers’ Acceptances”
“Bank Supervision Process”
“Commercial Real Estate and Construction Lending”
“Community Bank Consumer Compliance”
“Community Bank Fiduciary Activities Supervision”
“Conflicts of Interest”
“Consigned Items and Other Customer Services”
“Country Risk Management”
“Credit Card Lending”
“Emerging Market Country Products and Trading Activities”
“Examination Planning and Control”
“Federal Branches and Agencies Supervision”
“Insider Activities”
“Interest Rate Risk”
“Internal and External Audits”
“Internal Control”
“Internet Banking”
“Introduction” (to the *Comptroller’s Handbook*)
“Investment Management Services”
“Large Bank Supervision”
“Lease Financing”
“Liquidity”
“Litigation and Other Legal Matters”
“Loan Portfolio Management”
“Management Information Systems”

"Mortgage Banking"
"Rating Credit Risk"
"Risk Management of Financial Derivatives"
"Sampling Methodologies"
"Trade Finance"

For examination areas that are not currently covered by booklets from the *Comptroller's Handbook*, examiners should continue to refer to the appropriate sections in *The Comptroller's Handbook for National Bank Examiners*.